



Please write clearly in block capitals.

Centre number

--	--	--	--	--

Candidate number

--	--	--	--

Surname

StemUp Model Solution

Forename(s)

Candidate signature

I declare this is my own work.

AS ECONOMICS

Paper 2 The National Economy in a Global Context

Monday 20 May 2024

Morning

Time allowed: 1 hour 30 minutes

Materials

For this paper you must have:

- the Insert
- a calculator.

Instructions

- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Fill in the boxes at the top of this page.
- Answer **all** questions in **Section A**.
- Answer **either** Context 1 **or** Context 2 in **Section B**.
- You will need to refer to the Insert provided to answer **Section B**.
- You must answer the questions in the spaces provided. Do not write outside the box around each page or on blank pages.
- If you need extra space for your answer(s), use the lined pages at the end of this book. Write the question number against your answer(s).
- Do all rough work in this book. Cross through any work you do not want to be marked.

Information

- The maximum mark for this paper is 70.
- The marks for questions are shown in brackets.
- No deductions will be made for wrong answers.

For Examiner's Use

Section	Mark
A	
B	
TOTAL	



J U N 2 4 7 1 3 5 2 0 1

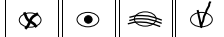
stemup.co.uk IB/M/Jun24/G4002/E5

7135/2

Section A

Answer **all** questions in this section.Only **one** answer per question is allowed.

For each question completely fill in the circle alongside the appropriate answer.

CORRECT METHOD WRONG METHODS If you want to change your answer you must cross out your original answer as shown. If you wish to return to an answer previously crossed out, ring the answer you now wish to select as shown. **0 1** Which one of the following is a measure of productivity?**[1 mark]**

- A** Employment divided by output 
- B** Output of goods per worker 
- C** Production multiplied by quantity of labour 
- D** Volume of goods produced 

0 2 Between 2021 and 2022, the weight applied to the restaurant and hotels sector in the Consumer Prices Index rose from 97 to 102.

As a result of this change, it must be true that

[1 mark]

- A** average prices in the restaurant and hotels sector rose by just over 5% between 2021 and 2022. 
- B** restaurant and hotel prices rose by less than the overall average for consumer prices in 2021. 
- C** the proportion of average consumer expenditure relating to restaurants and hotels rose in 2022. 
- D** total consumer expenditure on restaurant and hotel services was higher in 2022 than in 2021. 



0 3

Table 1 shows selected data for a country for 2022 and 2023.

Table 1

	2022	2023
Exports (\$bn)	10	12
Government spending (\$bn)	12	14
Investment (\$bn)	40	38

The country's national income was in equilibrium in 2022 and 2023. All other things being equal, which one of the following is most likely to have occurred in this country in 2023 to maintain equilibrium national income?

[1 mark]

- A** A decrease in tax revenue ☐
- B** A fall in the value of imports ☐
- C** A rise in the budget deficit ☐
- D** An increase in savings ☒

0 4

An aggregate demand and short-run aggregate supply diagram is used to illustrate the effect of a rise in imports of goods and services into an economy. All other things being equal, which one of the following would be shown on the diagram?

[1 mark]

- A** A leftward movement along the aggregate demand curve ☐
- B** A leftward movement along the short-run aggregate supply curve ☒
- C** A rightward shift of the aggregate demand curve ☐
- D** A rightward shift of the short-run aggregate supply curve ☐

Turn over ►



0 5

All other things being equal, which one of the following is the most likely cause of a reduction in a country's surplus on its balance of payments on current account?

[1 mark]

- A** A depreciation in the exchange rate ☐
- B** Contractionary fiscal policy ☐
- C** Falling labour productivity ☒
- D** Growth in export markets ☐

0 6

Disinflation exists when

[1 mark]

- A** an economy experiences a fall in the cost of living. ☐
- B** deflation has occurred for two or more successive quarters. ☐
- C** nominal incomes are rising more slowly than prices. ☐
- D** the price level is rising less quickly than previously. ☒

0 7

Which one of the following is most likely to cause a rightward shift of the long-run aggregate supply curve?

[1 mark]

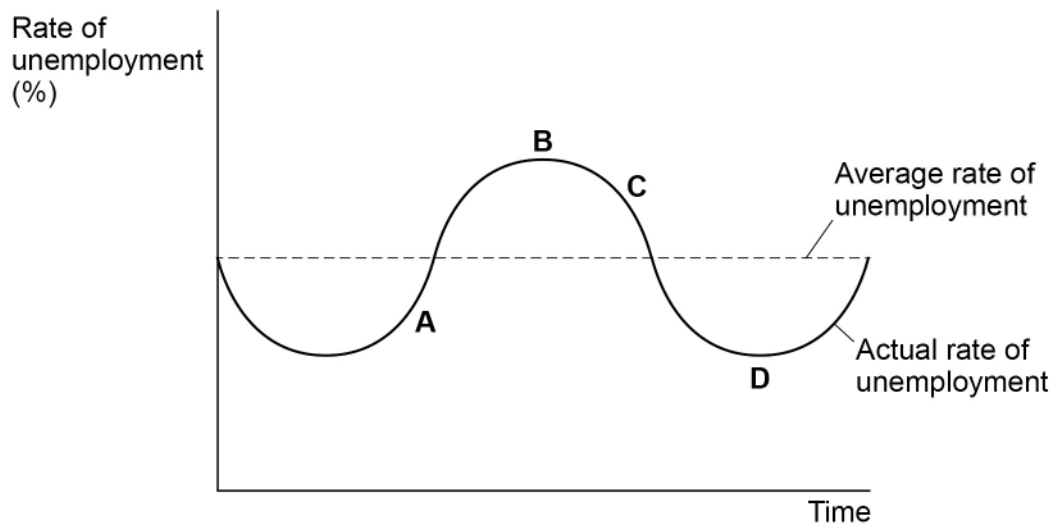
- A** A fall in the supply of credit ☐
- B** A reduction in geographical immobility of labour ☒
- C** A rise in the cost of new technology ☐
- D** An increase in welfare benefit payments ☐



0 8

Figure 1 shows the rate of unemployment in an economy over a period of time.

Figure 1



At which one of the following points was the economy most likely to be in the recovery phase of the economic cycle?

[1 mark]

A Point A

☐

B Point B

☐

C Point C

☒

D Point D

☐

Turn over for the next question

Turn over ►



0 9

Which type of unemployment is caused by a fall in aggregate demand leading to a fall in the demand for labour?

[1 mark]

A Cyclical

☒

B Frictional

☐

C Seasonal

☐

D Structural

☐

1 0

Country W is operating at its normal capacity level of output. When one of its trading partners experiences economic growth, this leads to a rise in demand for Country W's exports.

All other things being equal, what is the most likely consequence of this for Country W?

[1 mark]

A A fall in employment and a reduction in cost-push inflation

☐

B A negative output gap and a period of disinflation

☐

C A positive output gap and an increase in demand-pull inflation

☒

D An increase in unemployment and a fall in the price level

☐

1 1

Which one of the following explains the operation of the accelerator process in an economy?

[1 mark]

A Increasing investment leads to a rise in aggregate demand

☐

B National income increases as a result of rising investment

☐

C National income rises as a result of an increase in aggregate demand

☐

D Rising national income leads to an increase in investment

☒
1 2

A government is considering how to fund additional spending on healthcare. One option is to raise the rate of tax charged on the whole of firms' profits from 19% to 25%.

All other things being equal, for every 10 firms earning profits of £1 million, by how much could the government increase its spending on healthcare without affecting the budget balance?

[1 mark]

A £60 000

☐

B £250 000

☐

C £600 000

☒

D £2 500 000

☐

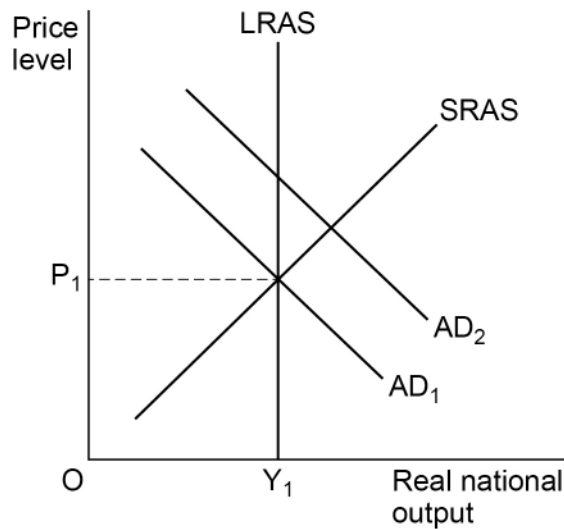
Turn over for the next question

Turn over ►



1 3

Figure 2 shows the aggregate demand (AD), short-run aggregate supply (SRAS) and long-run aggregate supply (LRAS) curves for an economy.

Figure 2

All other things being equal, which one of the following is the most likely consequence for firms if an increase in government spending shifts the aggregate demand curve from AD_1 to AD_2 ?

[1 mark]

- A** Increase in spare capacity
- B** Less corporation tax is paid
- C** More goods are exported
- D** Shortages of skilled labour

☐☐☐☒

1 4

Which one of the following statements regarding UK monetary policy is true?

[1 mark]

- A** The central bank considers the government's fiscal policy when setting Bank Rate.
- B** The central bank is responsible for setting the rate of corporation tax.
- C** The central bank sets the target rate of inflation as measured by the Consumer Prices Index.
- D** The central bank's decisions do not affect the government's budget balance.

☒☐☐☐

1 5

A firm spent £12m on capital goods and its exports increased by £8m. As a result, national income increased by £24m.

All other things being equal, what is the value of the multiplier?

[1 mark]**A** 0.8☐**B** 1.2☒**C** 2☐**D** 3☐**1 6**

A government is concerned that aggregate demand is growing faster than the productive capacity of the economy. In addition, the deficit on its balance of payments on current account has worsened.

Which one of the following policies is most likely to both reduce aggregate demand and help improve the balance of payments position?

[1 mark]

A A reduction in interest rates to cut mortgage repayments and lower the exchange rate

☐

B A reduction in taxes on company profits to encourage more innovation and investment

☐

C An increase in government borrowing to fund infrastructure spending and improve productivity

☐

D An increase in tax rates and a reduction in welfare payments to create a budget surplus

☒

Turn over for the next question

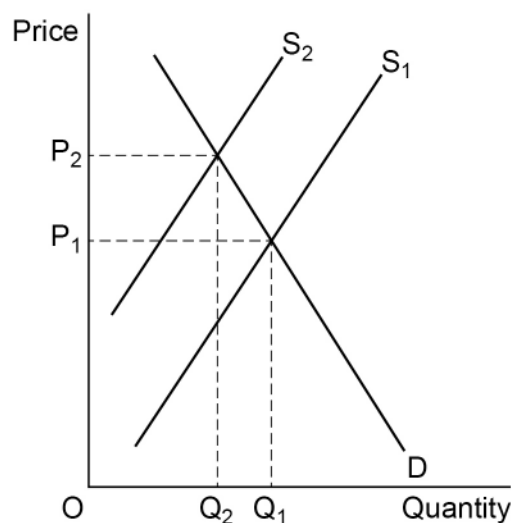
Turn over ►



1 7

Figure 3 shows the demand (D) and supply (S) curves for a good in a market.

Figure 3



The diagram shows a shift of the supply curve for the good from S_1 to S_2 caused by the removal of a subsidy. All other things being equal, which one of the following is the most likely consequence of this action?

[1 mark]

- A** A change in the pattern of economic activity
- B** A decrease in the budget surplus
- C** A reduction in the balance of payments deficit
- D** An increase in direct tax revenue

☒
☐
☐
☐


1 8

Between October 2022 and July 2023, the value of the US Dollar (US\$) in terms of the Swiss Franc (CHF) changed from US\$ 1 = CHF 1 to US\$ 1 = CHF 0.87.

All other things being equal, this means that

[1 mark]

- A** the Swiss Franc and the US Dollar are no longer in equilibrium. ☐
- B** the Swiss Franc has become weaker against the US Dollar. ☐
- C** the volume of exports from Switzerland to the USA is likely to increase. ☐
- D** the volume of imports to Switzerland from the USA is likely to increase. ☒

1 9

Table 2 shows the indices of labour productivity and real GDP for Country A and Country B for 2 years.

Table 2

	Index of labour productivity		Index of real GDP	
	Year 1	Year 2	Year 1	Year 2
Country A	100	110	100	120
Country B	100	105	100	110

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

[1 mark]

- A** In Year 2, labour productivity and real GDP were higher in Country A than Country B. ☐
- B** In Year 2, real GDP per capita was higher in Country A than Country B. ☐
- C** Labour productivity and real GDP grew more quickly in Country A than Country B over the period. ☒
- D** Real GDP per capita grew more quickly in Country A than in Country B. ☐

Turn over ►

2 0

Which one of the following is most likely to bring about a supply-side improvement in an economy?

A fall in

[1 mark]

A company profits

☐

B incentives for enterprise

☐

C income tax rates

☒

D labour productivity

☐

20

END OF SECTION A



Section B

Look at the Insert and choose to answer **EITHER** Context 1 **OR** Context 2.

Answer **EITHER** Questions 21 to 26 in the spaces below

OR

Questions 27 to 32 on pages 24 to 32 of this answer booklet.

There is a total of 50 marks for either context.

Shade the circle below to indicate which context you have answered.

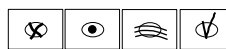
Context **0** **1** ☐

Context **0** **2** ☐

CORRECT METHOD



WRONG METHODS



EITHER

Context 1

Total for this context: 50 marks

TROUBLING TIMES FOR THE UK ECONOMY

Use the Insert provided to study **Questions 21 to 26** and **Extracts A, B and C**, and then answer the questions in the spaces which follow.

2 **1** Define 'Regressive taxes' **Extract C** (line 12).

[3 marks]

A regressive tax is a tax where the proportion of income paid in tax falls as income rises, so it takes a larger percentage of the income of low-income earners than of high-income earners, for example VAT.

Turn over ►



2 2

A homeowner has an interest-only mortgage of £225 000. The annual interest rate paid on their mortgage has increased from 2% to 4.3%.

Calculate the increase in the amount of interest paid per month to the **nearest pound (£)**.

[4 marks]

$$\text{Rise in interest rate} = 4.3\% - 2\% = 2.3 \text{ percentage points}$$

$$\text{Increase in annual interest} = £225\,000 \times 0.023 = £5175 \text{ per year}$$

$$\text{Increase per month} = £5175 \div 12 = £431.25$$

$$\text{Check: } (£225\,000 \times 0.043) \div 12 = £806.25 \text{ and } (£225\,000 \times 0.02) \div 12 = £375, \text{ so } £806.25 - £375 = £431.25$$

$$\text{Increase in monthly interest} = £431 \text{ (to the nearest £)}$$



2 3

Use **Extract A** to identify **two** significant points of comparison between inflation and the growth in average weekly real earnings over the period shown.

[4 marks]

Point 1 *Over the period, CPIH inflation rose from 0.8% in December 2020 to 9.3% in November 2022, whereas growth in average weekly real earnings fell from 3.5% in December 2020 to -2.4% in November 2022.*

Extra space

Point 2 *Before August 2021 real earnings growth was higher than inflation, eg in April 2021 it was 5.9% compared with inflation of 1.6%, whereas from August 2021 inflation was always higher, eg 3% compared with real earnings growth of 1.8% in August 2021.*

Extra space

Turn over for the next question

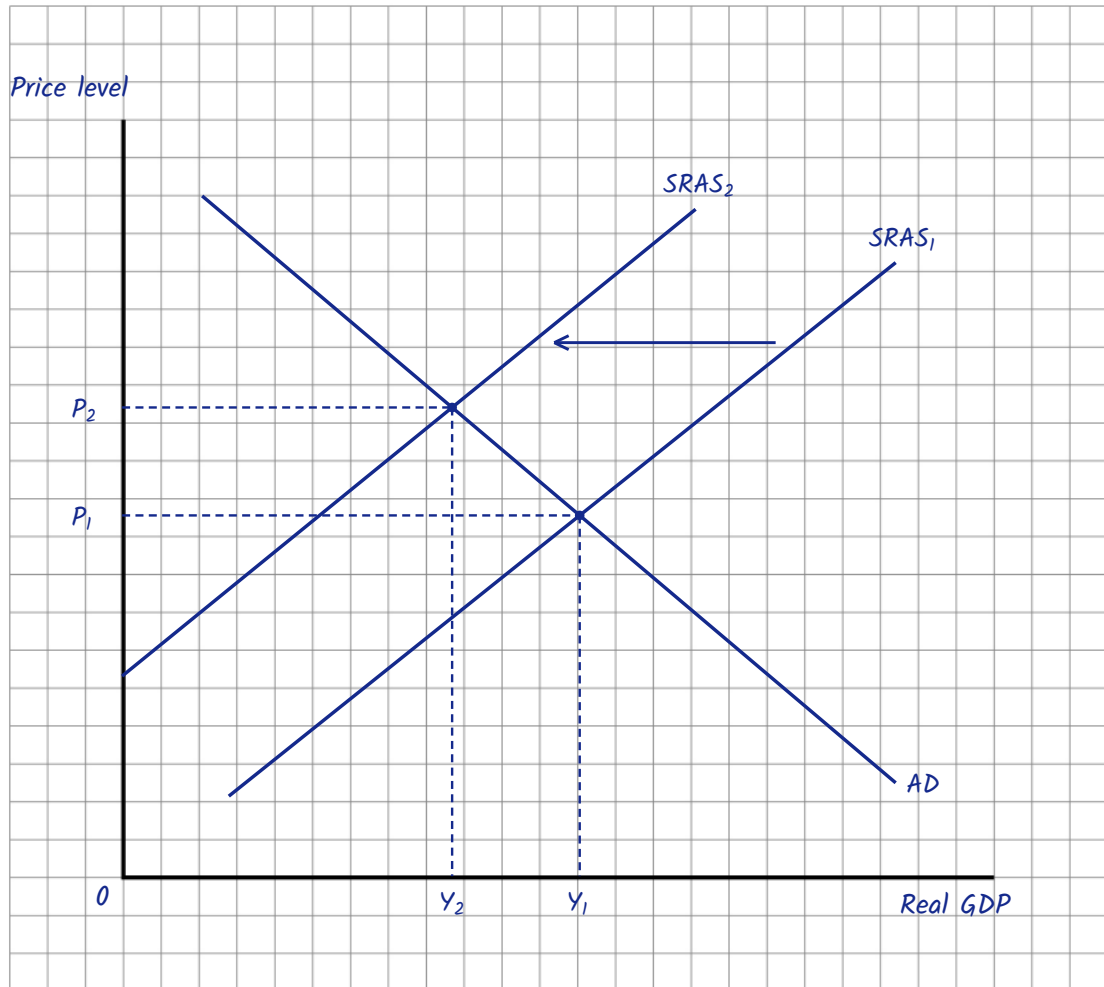
Turn over ►



2 4

Extract B (lines 1–3) states: ‘...rapid increases in the price of commodities, such as gas and wheat...led to a 40-year high inflation rate...’.

Draw an AD/AS diagram to show how rising commodity prices are likely to affect the macroeconomy.

[4 marks]

2 5

Extract B (lines 11–12) states: ‘In response, as inflation rose above the target rate, the Bank of England's Monetary Policy Committee acted by increasing Bank Rate.’

Explain how an increase in Bank Rate may lead to a reduction in the rate of inflation.

[10 marks]

Bank Rate is the interest rate the Bank of England pays on reserves held by commercial banks, and it is the main instrument of UK monetary policy. The MPC raises it when CPI inflation is above the 2% target, as in 2022 when inflation reached 11.7% (Extract B).

First, a higher Bank Rate is passed on by commercial banks, so interest rates on loans, mortgages and credit cards rise, as do rates on savings. This increases the cost of borrowing and the reward for saving. Households with variable-rate mortgages face higher monthly repayments (Extract B), which cuts their disposable income, while saving becomes more attractive than spending, so consumption (C) falls. Spending on credit-financed goods such as cars and furniture falls most. Higher rates may also reduce house prices, creating a negative wealth effect and lowering confidence.

Second, firms face a higher cost of borrowing, so fewer investment projects are profitable at the higher rate and investment (I) falls. Falling consumption also reduces expected sales, so via the accelerator firms cut investment further.

Third, higher UK interest rates attract hot money inflows, raising demand for sterling so the exchange rate appreciates. UK exports become dearer abroad and imports cheaper, so net exports (X – M) fall.

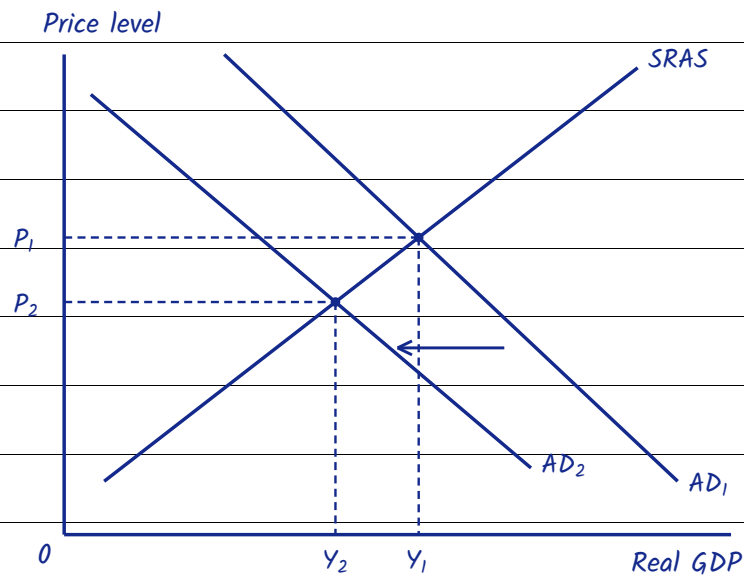
As C, I and (X – M) are components of AD, AD shifts left from AD_1 to AD_2 , as shown in the diagram, and the multiplier process magnifies the fall.

Firms face weaker demand and spare capacity, so they raise prices less quickly and demand-pull inflation falls; the price level rises less, from P_1 to P_2 rather than rising further. Weaker labour demand also reduces wage

Turn over ►



Extra space



pressure.

In addition, the stronger pound makes imported raw materials, such as gas and wheat, cheaper in sterling, lowering firms' costs of production. This shifts SRAS to the right and reduces cost-push inflation. Higher Bank Rate also signals the Bank's commitment to the target, lowering inflation expectations so workers ask for smaller pay rises. However, these effects work with a time lag of up to two years, so inflation falls only gradually.



2 6

Extract C (lines 17–18) states: ‘These policies could restrict economic growth in the short term and increase the likelihood of the economy going into recession.’

Use the extracts and your knowledge of economics to evaluate policies that might help an economy to recover from a recession.

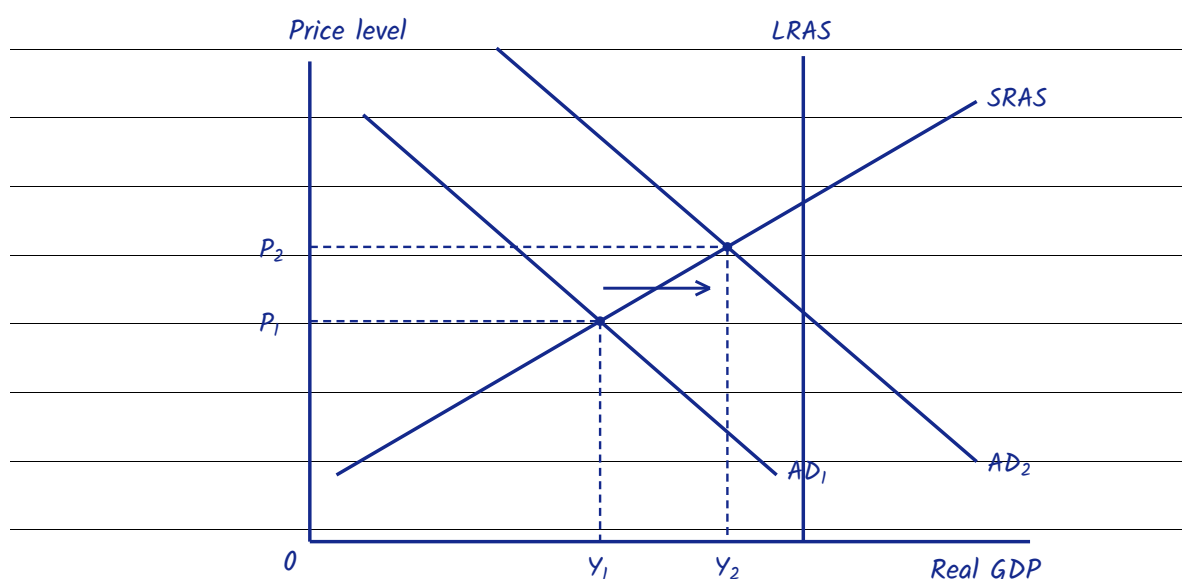
[25 marks]

A recession is usually defined as two consecutive quarters of negative real GDP growth. In a recession there is a negative output gap: unemployment rises, incomes and confidence fall and firms hold spare capacity. Extract C shows the UK was close to this in 2022, with only 0.1% growth in the final quarter, retail sales volumes down 3% and business investment down 2.5% in the third quarter. Recovery requires a rise in real GDP back towards the trend rate, which usually means boosting aggregate demand (AD) and, in the long run, aggregate supply.

One policy is expansionary fiscal policy: raising government spending (G) and/or cutting taxes. Higher spending on infrastructure, health or education directly increases AD, while lower income tax or VAT raises disposable income and so consumption. As shown in the diagram, AD shifts right from AD_1 to AD_2 and real GDP rises from Y_1 to Y_2 , closing the negative output gap with only a small rise in the price level from P_1 to P_2 because there is spare capacity. The injection is magnified by the multiplier, as workers who are hired spend part of their extra income, creating further rounds of spending, and the accelerator means rising sales encourage firms to invest. Fiscal policy is also powerful because the government can target spending at the areas and households hit hardest, and it can boost confidence directly. However, fiscal policy has drawbacks. It increases the budget deficit and national debt. Extract C notes that government debt was forecast to reach 106.7% of GDP in 2023/24, which is why the Chancellor ruled out expansionary fiscal policy and instead raised taxes, such as freezing tax

Turn over ►





thresholds and increasing corporation tax by 6 percentage points to 25%.

Extra borrowing may raise interest rates and crowd out private investment, and if markets lose confidence in public finances, borrowing costs could rise sharply. There are also time lags, as infrastructure projects take years to plan, and the multiplier may be small if much of the extra income is saved or spent on imports. Finally, if inflation is high, as in 2022, a large boost to AD may simply add to inflation rather than output.

A second policy is expansionary monetary policy. The Bank of England could cut Bank Rate, which lowers the cost of borrowing and the reward for saving, so consumption and investment rise. Lower mortgage repayments increase disposable income, and lower rates tend to depreciate sterling, making exports more competitive and raising net exports. Each of these increases AD. If Bank Rate is already very low, the Bank could use quantitative easing, buying bonds to inject money into the economy and push down long-term interest rates. Monetary policy can be changed quickly by the independent MPC and does not add to government borrowing. Yet its effectiveness depends on confidence. In a deep recession, households



Extra space *and firms may not want to borrow even at low rates because they fear unemployment or falling sales, so a cut may have little effect. Banks may also be unwilling to lend. In 2022 to 2023 the MPC was actually raising Bank Rate because inflation was 11.7%, well above the 2% target (Extract B), so cutting rates would conflict with price stability. The depreciation would also make imports dearer, adding cost-push inflation. Monetary policy works with time lags of up to two years.*

A third approach is supply-side policy, such as spending on education and training, infrastructure, tax incentives for investment and deregulation. These raise productivity and shift LRAS to the right, increasing the productive potential of the economy and allowing non-inflationary growth. Some supply-side measures, such as infrastructure spending, also raise AD in the short run. However, supply-side policies mainly work in the long run, so they do little to end a recession quickly, and interventionist measures cost money. Raising capacity when there is already spare capacity does not by itself increase output if demand is weak.

Finally, the government may argue, as in Extract C, that the best policy is to control inflation and borrowing first. Stable prices reduce uncertainty, help firms plan and protect real incomes, so confidence may return and the private sector may lead the recovery, helped by automatic stabilisers such as rising benefit payments and falling tax revenue. Recovery may also depend on external factors, such as falling energy prices or stronger growth in trading partners.

In conclusion, the most effective policy depends on the cause and depth of the recession, the rate of inflation and the state of public finances. When inflation is low and there is a large negative output gap, expansionary fiscal policy, supported by low interest rates, is likely to be most effective because

Turn over ►



of the multiplier and its speed in raising AD. However, in the UK in 2023, with inflation of 11.7% and debt close to 107% of GDP, large demand-side stimulus risks higher inflation and borrowing costs. In this case a combination is best: modest, targeted fiscal support for the worst-hit households, a cut in Bank Rate only once inflation is falling, and supply-side policies that raise productivity for sustained long-run growth. Overall, demand-side policies are needed for a quick recovery, but their success depends heavily on confidence and on not reigniting inflation.



Do not write
outside the
box

Handwriting practice area with 20 horizontal lines.

Turn over ►



Do **NOT** answer Context 2 if you have answered Context 1.

OR

Context 2

Total for this context: 50 marks

THE LEVELLING-UP AGENDA

Use the Insert provided to study **Questions 27 to 32** and **Extracts D, E and F**, and then answer the questions in the spaces which follow.

2 7 Define 'GDP per capita' **Extract E** (line 3).

[3 marks]

GDP per capita is the total value of all goods and services produced in an economy over a period of time, usually a year, divided by the population, ie the value of output per person.

2 8 Use **Extract D** to calculate, as a percentage, how much nominal GDP per capita in the poorest region would need to rise, to equal nominal GDP per capita in the richest region.

Give your answer to the **nearest whole percent (%)**.

[4 marks]

Poorest region = North East, £23 109; richest region = South East, £34

516

Difference = £34 516 - £23 109 = £11 407

Percentage rise needed = $(11\,407 \div 23\,109) \times 100 = 49.36\%$

Nominal GDP per capita in the North East would need to rise by 49% (to the nearest whole percent)



2 9

Use **Extract D** to identify **two** significant points of comparison between employment rates and inactivity rates in selected regions of the UK.

[4 marks]

Point 1 *The South East had both the highest employment rate, 79.0%, and the lowest inactivity rate, 17.7%, and it is the only region with an employment rate above the UK average of 75.8% and an inactivity rate below the UK average of 21.1%.*

Extra space

Point 2 *Northern Ireland had both the lowest employment rate, 71.9%, and the highest inactivity rate, 26.2%. The range for employment rates (7.1 percentage points) was smaller than the range for inactivity rates (8.5 percentage points).*

Extra space

Turn over for the next question

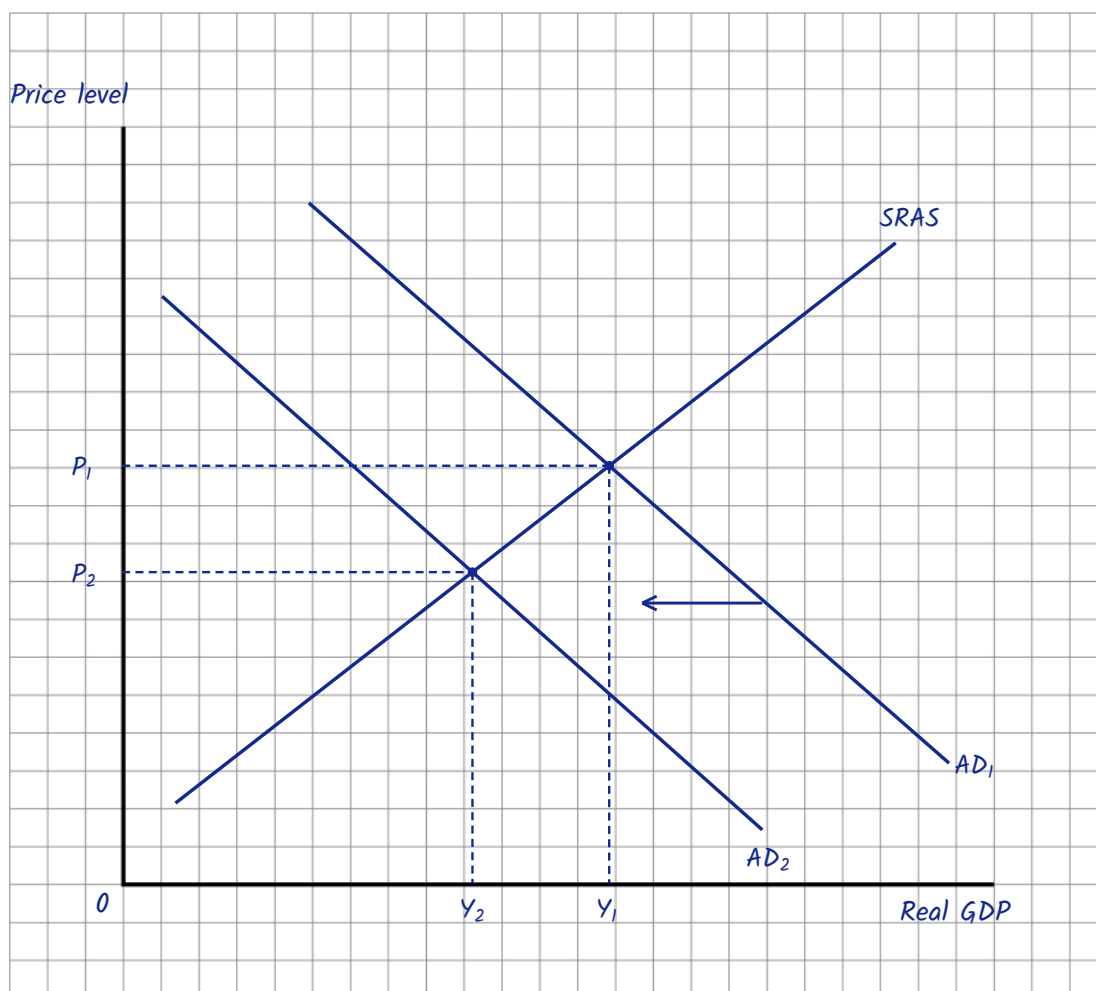
Turn over ►



3 0

Extract E (lines 20–21) states: ‘...the government intends to cut the budget deficit to reduce borrowing’.

Draw an AD/AS diagram to show the most likely short-run effect of reducing the budget deficit on the macroeconomy.

[4 marks]

3 1

Extract F (lines 1–2) states: 'Unless the UK Government provides additional support, the outlook for some poorer regions may be gloomy. They often suffer from structural unemployment'.

Explain why some regions of the UK suffer from structural unemployment.

[10 marks]

Structural unemployment occurs when there is a long-term decline in demand for the output of an industry, so workers lose their jobs, and their skills or location do not match the vacancies available. It is concentrated in particular regions because industries such as coal, steel, shipbuilding and textiles were geographically clustered, for example in the North East, Wales and Northern Ireland.

One cause is changing demand conditions. As incomes rise, demand shifts towards services and away from manufactured goods, and consumers may switch to cheaper imports. The demand for labour is derived from the demand for the product, so the demand for labour in the declining industry falls from D_{L1} to D_{L2} , as shown in the diagram, and employment falls from N_1 to N_2 .

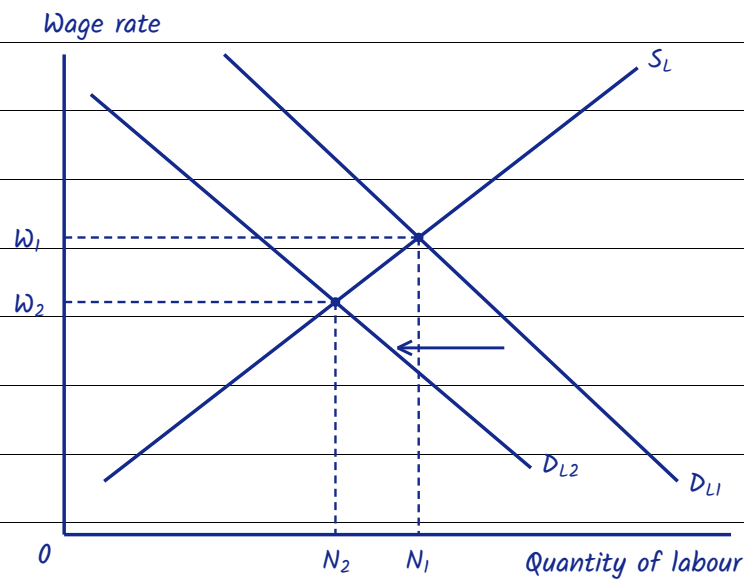
A second cause is changing supply conditions and falling international competitiveness. Countries with lower labour costs, such as China, can produce manufactured goods more cheaply, so UK firms lose market share and close plants. Technological progress and automation also replace workers with machines, so fewer workers are needed even where output is maintained.

These job losses then spread through the region. Unemployed workers have lower incomes and cut spending, so local shops and suppliers lose sales and lay off workers too: a downward multiplier effect, which Extract F says 'can cause even greater decline'. Low consumption and poor confidence reduce expected profits, so firms are unwilling to invest in the region (Accelerator

Turn over ►



Extra space



effect), and few new jobs are created to replace those lost.

Structural unemployment persists because of occupational immobility: workers from heavy industry lack the skills needed for growing sectors such as finance or digital services, and low literacy (Extract F) makes retraining harder. Geographical immobility also matters: high house prices and rents in the South East, family ties and a lack of information prevent workers moving to areas with vacancies, while poor transport links limit commuting. This explains why employment is only 73.1% in the North East compared with 79.0% in the South East (Extract D), and why the problem is long-lasting unless the government intervenes.



3 2

Extract F (lines 5–6) states: ‘As part of its long-term plan, the government has 12 levelling-up ‘missions’ or objectives. These include raising pay, employment and productivity throughout the UK’.

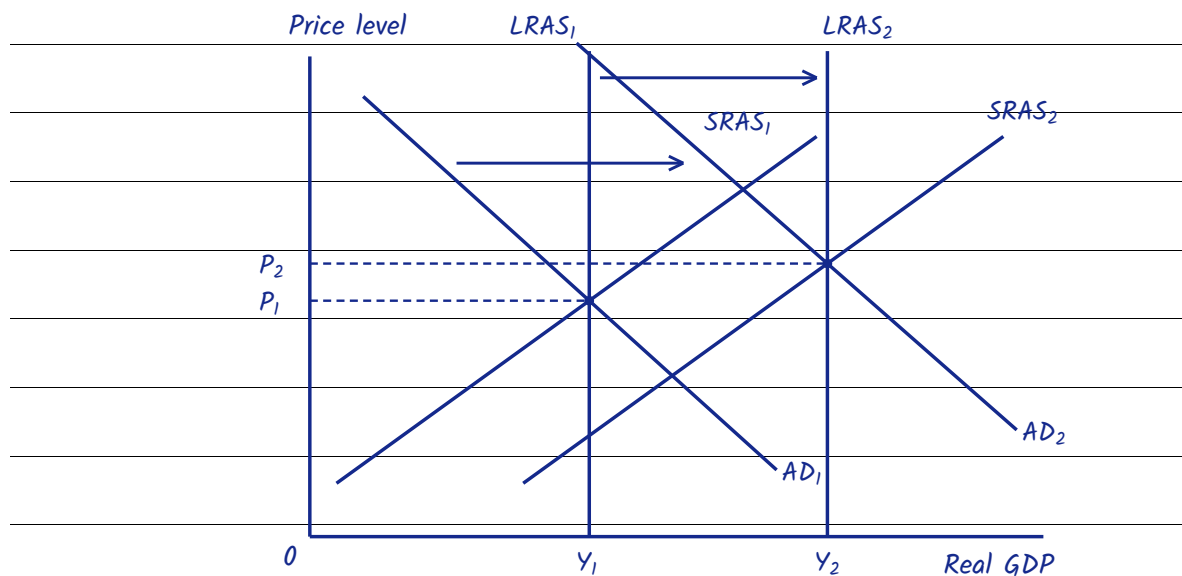
Use the extracts and your knowledge of economics to assess the view that the government should increase the amount of spending allocated to poorer regions of the UK.

[25 marks]

Government spending is expenditure by the state on public services, infrastructure and welfare, and increasing it in particular regions is both a fiscal policy and, where it improves skills and transport, a supply-side policy. The 'poorer regions' are those with low output and incomes: Extract D shows nominal GDP per capita of only £23 109 in the North East and £23 882 in Wales, compared with £34 516 in the South East, while employment rates are lower and inactivity rates higher, eg 26.2% in Northern Ireland. The main argument for more spending is that it can raise employment and incomes. Spending on projects such as the £50 million eco-tourism scheme in Morecambe (Extract E) is an injection that increases AD in the region. Where there is spare capacity and high unemployment, this creates jobs with little inflationary pressure, and the multiplier means the newly employed spend their incomes in local businesses, creating further jobs. Rising demand then encourages private investment through the accelerator, reversing the downward spiral described in Extract F. Spending can also raise productivity and therefore long-run growth. Investment in public transport, to match the quality found in London, reduces geographical immobility and widens labour markets, while spending on education and high-quality skills training reduces occupational immobility and structural unemployment. As shown in the diagram, these supply-side effects shift LRAS from LRAS₁ to LRAS₂ as well as raising AD, so real GDP rises from Y₁ to Y₂ without a large rise in the price level. Extract F argues that higher productivity leads to rising real wages, higher consumption,

Turn over ►





falling unemployment and improved international competitiveness, which would also help the UK's current account and raise UK-wide growth, since cities such as Manchester and Birmingham lag behind similar foreign cities (Extract E).

There is also an equity argument. The UK has more regional inequality than most major economies, and poor regions have worse health, literacy and life expectancy. Reducing these gaps improves well-being and may reduce spending on benefits in the long run. Extract E shows that in Germany and the Netherlands, targeted regional support helped regional inequality fall for 20 years, suggesting the policy can work.

However, there are strong arguments against. First, the opportunity cost: the government intends to cut the budget deficit (Extract E), so extra regional spending must either be funded by higher taxes, which may reduce incentives to work and invest, by more borrowing, which adds to the national debt and interest payments, or by cuts elsewhere, perhaps in other public services. Some 'levelling-up' money may simply be diverted from other budgets rather than being additional.



Extra space *Second, the spending may be ineffective. Extract E stresses that funds must be 'spent effectively', and £2.1 billion spread across more than 100 projects is small relative to the size of the gap. Projects chosen for political reasons may have little long-run impact, and government failure is possible because officials lack information about which investments will raise productivity. If much of the extra income leaks into imports or into other regions, the local multiplier will be small.*

Third, focusing on poorer regions may be the wrong target. There are deprived areas within rich regions, such as parts of London and the South East, which might lose out, while some prosperous areas exist within poorer regions. Better transport might even encourage skilled workers to leave poorer regions. In addition, Extract F argues that the responsibility does not rest solely with the government: incentives such as tax breaks or match funding, as in Morecambe, may attract private-sector investment more cheaply than direct spending, and market forces such as lower wages and land costs may draw firms to these regions anyway.

Finally, the effects take time. Education and infrastructure spending may take a decade or more to raise productivity, so the 2030 target to close the gap may not be met, and future governments may change course.

In conclusion, I agree that the government should increase spending on poorer regions, but only if it is well targeted. The case is strongest where there is high unemployment and spare capacity, as in the North East and Northern Ireland, because the multiplier and accelerator effects will be large and the inflationary and crowding-out risks small. Spending should focus on supply-side measures with long-run returns, such as skills training and transport, rather than one-off projects, and it should be used to lever in private investment. Given the pressure to reduce the deficit, the size of the

Turn over ►



increase depends on whether it can be financed by redirecting less
productive spending; if it raises productivity and tax revenues in the long
run, it may partly pay for itself.

END OF QUESTIONS



There are no questions printed on this page

*Do not write
outside the
box*

**DO NOT WRITE ON THIS PAGE
ANSWER IN THE SPACES PROVIDED**



[illegible]

[illegible]

