PEARSON EDEXCEL A-LEVEL ECONOMICS B · 9EB0

ECONOMICS



EXAM QUESTION PACK

2.5 THE ECONOMIC CYCLE

ECONOMIC GROWTH

SCORE	PERCENTAGE
/315	%

STEMUP

These questions belong to Pearson Edexcel, not to us.

The examination questions and mark schemes in this pack were written and published by Pearson Edexcel. They are past assessment materials, reproduced here so that students can revise from them.

What we do not own

STEMUP is not affiliated with Pearson Edexcel and does not own, and makes no claim to own, any of the question or mark scheme material in this pack. Pearson has not endorsed, approved or been involved in the production of it. Pearson, Edexcel and the qualification titles used here belong to their respective owners and appear for identification only.

Where to find the originals

Pearson publishes its past papers and mark schemes free of charge. Always check the current specification at qualifications.pearson.com before you revise, because content and wording can change between series.

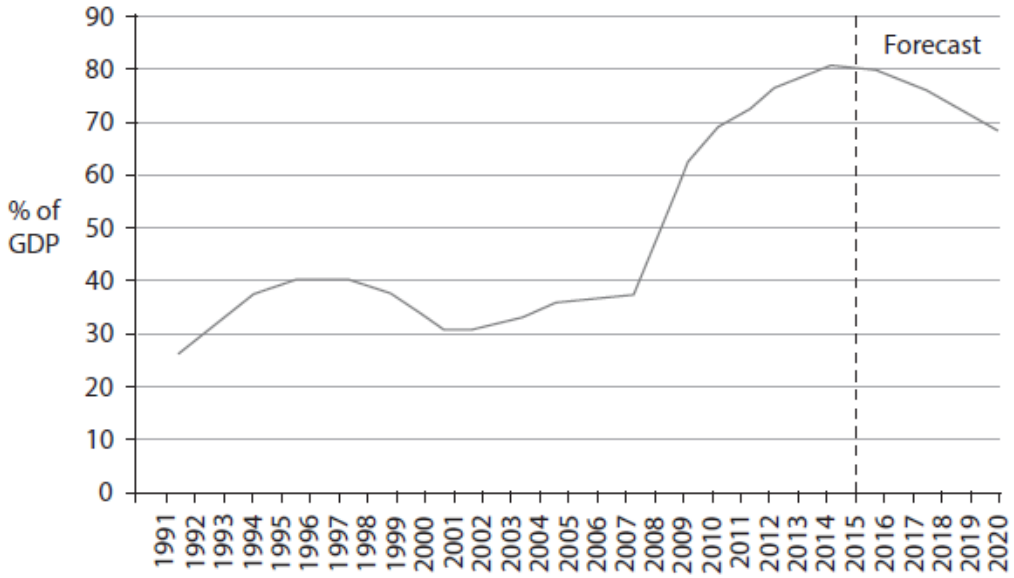
If you hold the rights to any material in this pack and would like it amended or removed, contact admin@stemup.co.uk and we will act on it.

Questions

Q1.

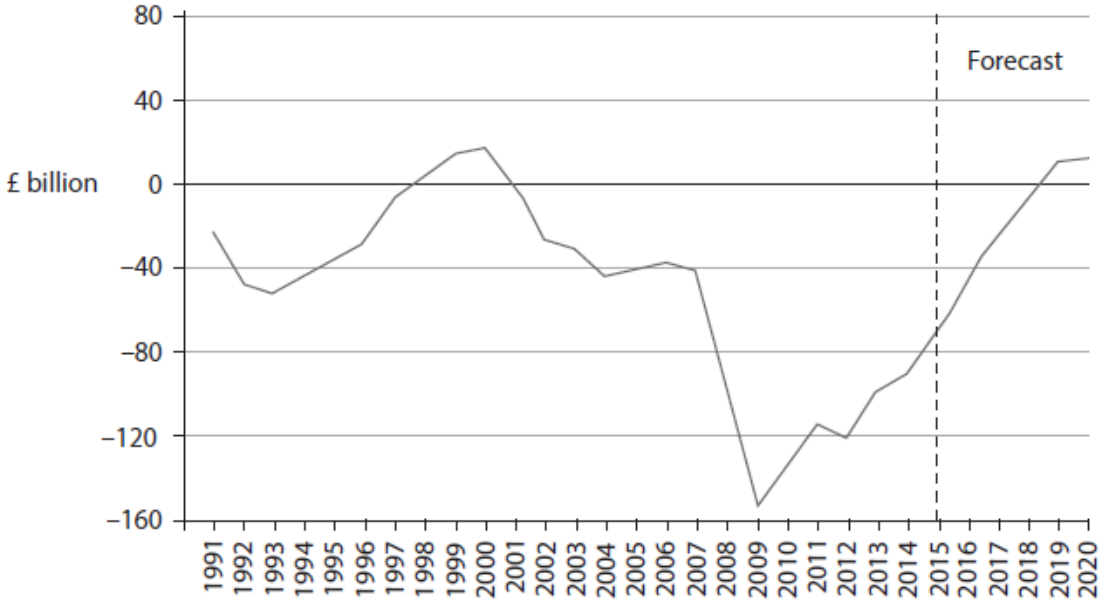
The UK economy

Figure 4: UK national debt as a percentage of GDP



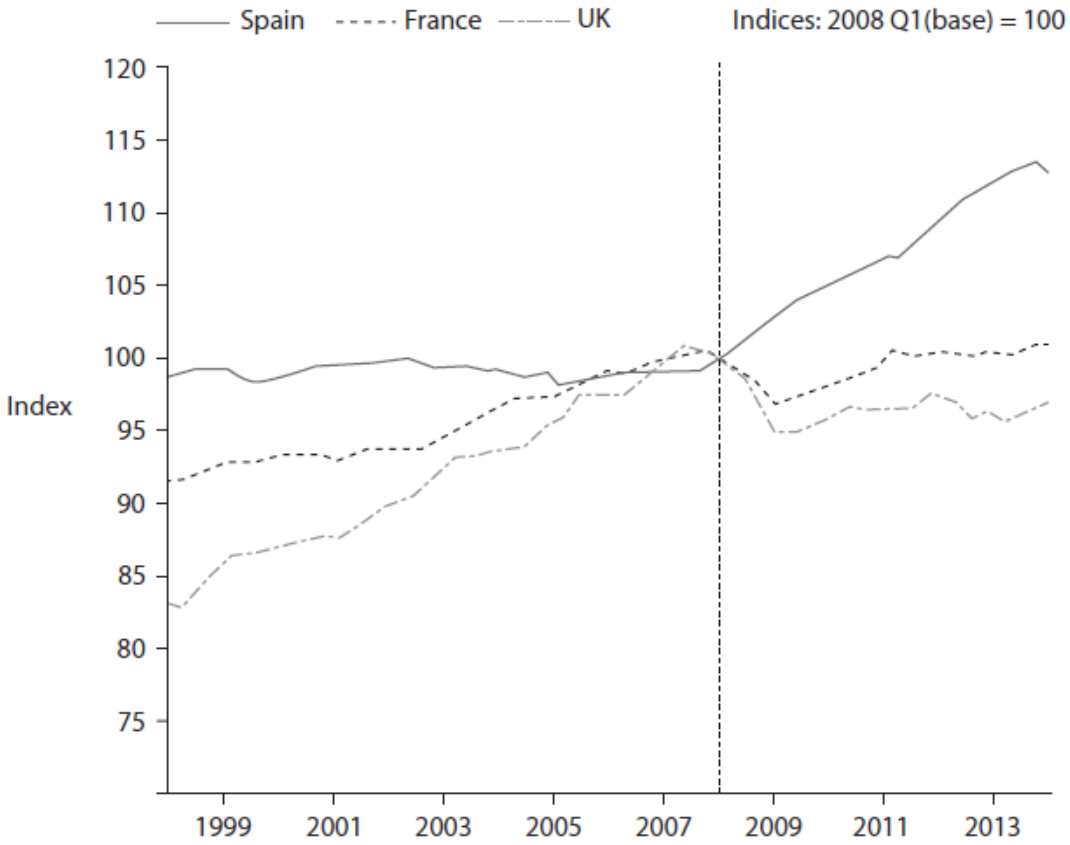
(Source: http://budgetresponsibility.org.uk/docs/dlm_uploads/BriefGuide_020511.pdf)

Figure 5: UK fiscal deficit, public sector net borrowing (PSNB)



(Source: http://budgetresponsibility.org.uk/docs/dlm_uploads/BriefGuide_020511.pdf)

Figure 6: Labour productivity per head, selected countries



(Source: http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q201.pdf)

Extract C

The National Living Wage (NLW)

The Government has announced that from 2016 it will introduce a Living Wage Premium that will apply on top of the National Minimum Wage (NMW) for employees aged 25 and over to deliver a National Living Wage (NLW) for those people. The main NMW will continue to be set for all employees aged 21 and over, so that those aged 21 to 24 will continue to be subject only to that rate.

The effective minimum wage for the 25+ age group will therefore be over 13% higher in 2020 than would otherwise have been the case, and result in a 0.3% increase in wage costs overall. Further impacts on real GDP are estimated to be higher productivity (+0.3%) but lower average hours worked (-0.2%) and higher unemployment. Overall real GDP is forecast to fall by 0.1% as a result of the NLW. However these forecasts depend on estimates of the likely elasticity of demand for labour.

Academic evidence suggests that changes to the NMW since 1999 have led to only limited effects on demand for labour in the UK. The types of work that will be affected are relatively labour intensive, which may limit the scope for firms to substitute towards using capital. Firms may also be expected to shift demand in favour of the under-25s given that they will not be subject to the NLW, which all else being equal would lead to a smaller reduction in overall labour demand. Some of the reduction in employees could also be partially offset by a rise in self-employment. But increasing the NLW to a higher proportion of median earnings may lead to bigger effects than have been experienced in the past.

(Sources: adapted from http://cdn.budgetresponsibility.independent.gov.uk/July-2015-EFO-234224.pdf and http://budgetresponsibility.independent.gov.uk/)

Extract D

The productivity puzzle in the UK

Since the onset of the 2007–2008 financial crisis, labour productivity growth in the UK has been exceptionally weak. Despite some modest improvements in 2013, whole-economy output per hour remains around 16% below the level implied by its pre-crisis trend. Even taking into account possible measurement issues and changes in the size of the service sector, this shortfall is large and is often referred to as the 'productivity puzzle'.

Measures of productivity can be used to inform estimates of an economy's ability to grow without generating excessive inflationary pressure, which makes understanding recent movements important for the conduct of monetary policy. During the initial phases of the recession, companies appear to have acted flexibly by holding on to labour and lowering levels of capacity utilisation in response to weak demand conditions. But the protracted weakness in productivity and the strength in employment growth over the past two years suggest that other factors are likely to be having a more persistent impact on the level of productivity. These factors are reduced investment in both physical and intangible capital, such as innovation and training, and failings in the labour market such as immobility of labour and under-employment of skilled workers. Some economists explain this by using the concept of an output gap.

(Source: adapted from http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q201.pdf)

(a) With reference to Extract D (line 18), explain the meaning of the term 'output gap'. Use an aggregate demand and aggregate supply diagram in your answer.

(5)

(b) With reference to Figures 4 and 5 and your own knowledge, examine the relationship between the national debt as a proportion of GDP and the fiscal deficit.

(8)

(c) Discuss the likely impact of the National Living Wage on the profitability of firms. Use a cost and revenue diagram in your answer.

(12)

EITHER

(d) With reference to the information provided and your own knowledge, evaluate the likely microeconomic and macroeconomic influences on the UK's international competitiveness.

(25)

OR

(e) With reference to the information provided and your own knowledge, evaluate the microeconomic and macroeconomic effects of a government policy of cutting public expenditure rather than raising taxes as a means of reducing a fiscal deficit.

(25)

(Total for question = 50 marks)

Q2.

UK economic recovery

Figure 1: Components of aggregate demand in selected countries 2014

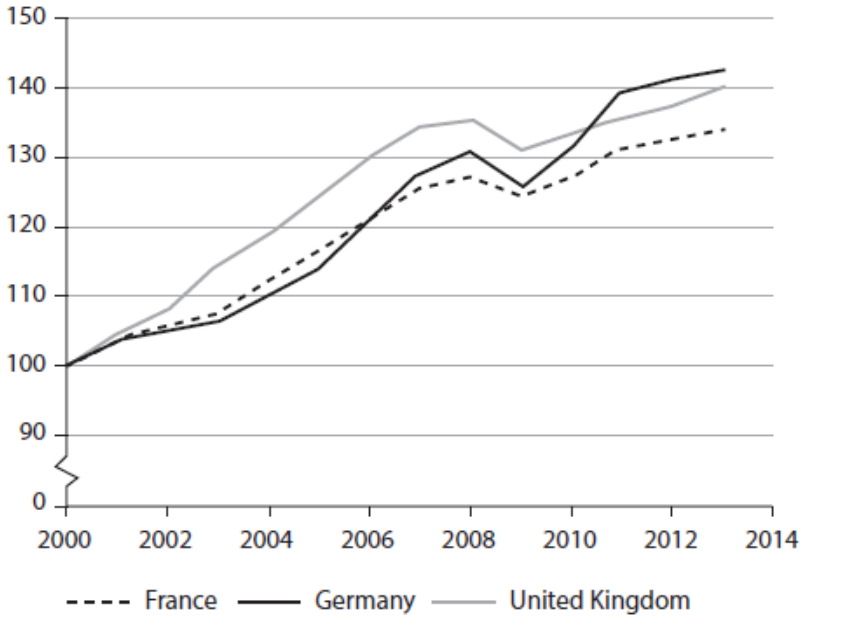
Country	Consumption	Investment	Government spending	Exports - Imports
UK	66%	14%	21%	–2%
Germany	57%	17%	19%	6%
France	57%	20%	25%	–2%
China	34%	49%	14%	3%

NB: Figures may not add up to 100% due to rounding calculations.

(Source: World Bank 2014)

Figure 2: Nominal GDP per capita at Purchasing Power Parities (PPPs)

(the base year 2000=100)



(Source: https://www.imf.org)

Extract A

The UK economy – a strange recovery

At the Autumn Statement in November 2015, the Chancellor of the Exchequer had good reason to cheer his economic record. The UK economy appeared to have returned towards its long-term trend in the rate of economic growth.

GDP growth has remained strong, with output rising at the highest rate in the G7 group of seven major industrialised countries. Unemployment continued to drop and business investment grew by 5%.

However, a number of concerns remain, particularly in relation to the UK's current account deficit, which reached a record high of 6% of GDP in the third quarter of 2014. This was primarily a result of a sharp decline in the rate of return on UK investments overseas. Low export growth meant that the UK's trade deficit persisted.

In 2012, the Chancellor had announced a target for the UK to export £1 trillion of goods and services by 2020, which would require an annual growth rate of 8%. However, the annual growth in UK exports had reached just 2.7%. The Office for Budget Responsibility (OBR) forecast that UK exports will only reach £630 billion by 2020 – a third lower than the government's target.

Exports in services continued to grow in 2015, but the UK's goods industries were struggling. It was particularly concerning that data showed output in the UK's construction and manufacturing industries falling. Indeed, the output of the manufacturing sector remained 6.3% below its pre-recession peak.

Households, meanwhile, are set to become even more indebted over the coming years. It is projected that the household gross debt to income ratio will rise by 26 percentage points between 2015 to 2020, returning to levels last seen before the Global Financial Crisis. The economy did not appear to be rebalancing away from consumer driven growth towards export-led growth, making another recession almost inevitable.

Fundamental to this problem is the UK's low productivity, which in 2015 remains around 20 percentage points below the average for the rest of the G7. It is vital that the government tackles this problem, particularly in the sectors that are currently facing difficulties. This will require relaxing the planning system to promote more house-building, the removal of burdens on UK manufacturers such as carbon taxes, finally getting shale gas exploration going, and reforming apprenticeships to rapidly improve skills in construction, manufacturing and technology.

(Source: adapted from http://www.cityam.com/229481/chancellor-beware-uk-not-out-woods-yet, 25 November 2015 by Daniel Mahoney)

(a) With reference to Figure 1, explain the term 'net trade'.

(4)

(b) With reference to the information provided and your own knowledge, assess the likely causes of the UK's trade deficit.

(10)

(c) With reference to Extract A, paragraph 2, explain **one** likely influence on UK investment.

(5)

(d) With reference to Figure 2 and Extract A, explain **two** likely reasons why the growth of the UK's nominal GDP per capita at PPPs was slower than that of Germany after 2010.

(6)

(e) Evaluate policies the government could use to increase the UK's productivity.

(15)

EITHER

(f) Evaluate the benefits of economic growth to the UK given that 'a number of concerns remain' in the UK economy (Extract A, line 7).

(20)

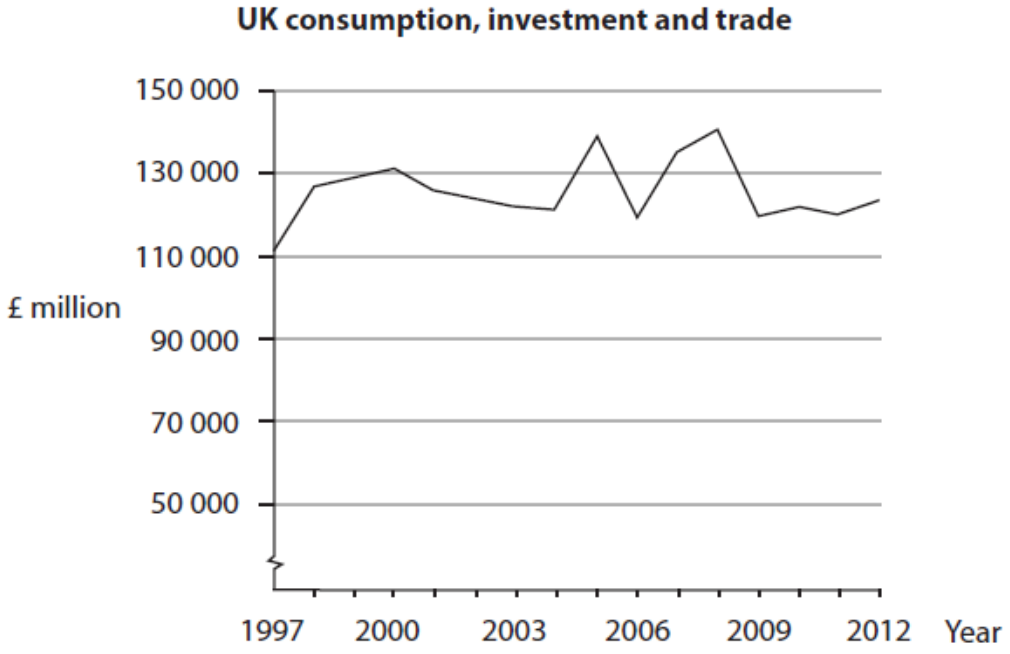
OR

(g) Evaluate the view that another recession is 'inevitable' in the UK (Extract A, line 24).

(20)

(Total for question = 60 marks)

Q3.

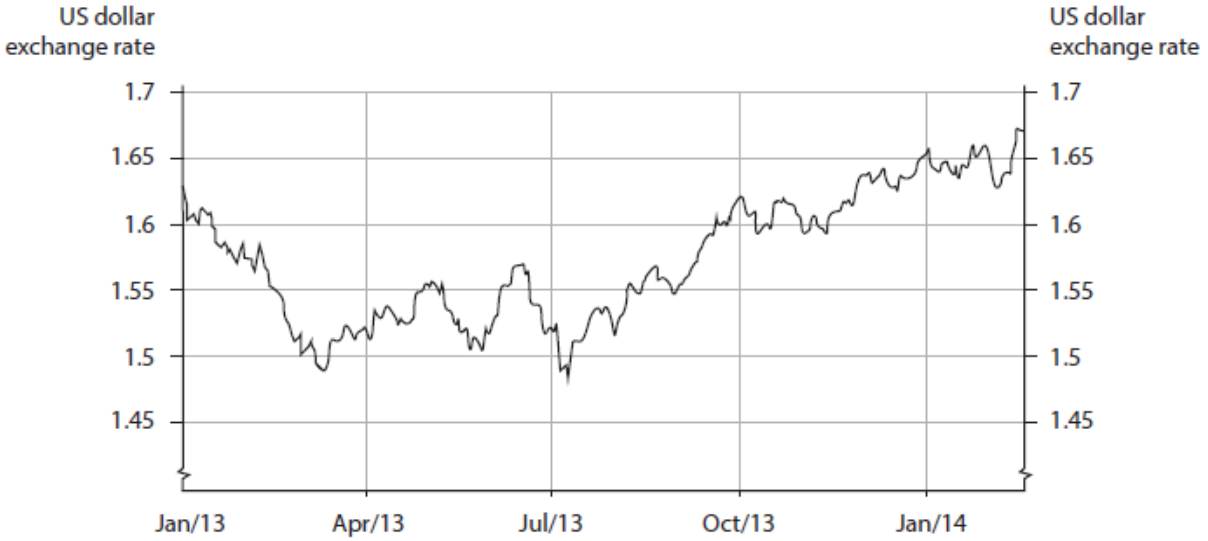


(Source: http://www.ons.gov.uk/ons/rel/bus-invest/business-investment/q3-2013-provisional-results/stb-business-investment-q3-2013-provisional.html#tab-Business-Investment-and-other-components-of-GFCF)

Figure 1: UK real annual business investment, 1997–2012 (seasonally adjusted)

(a) With reference to Figure 1, explain what has happened to real annual business investment since 2008.

(4)



(Source: http://www.tradingeconomics.com/united-kingdom/currency)

Figure 2: British pound (£) to US dollar ($) exchange rate, 1 January 2013 to mid-February 2014

(b) With reference to Figure 2, explain the likely effect of an appreciation of the British pound (£) against the US dollar ($) on the volume of UK imports from, and UK exports to, the USA.

(5)

Extract A

Why Britain needs a pay rise

UK growth in 2013 has been caused mainly by increases in consumption. Rising consumption tends to encourage companies to invest. The increase in demand for goods and services means firms need more productive capacity, often moving to bigger premises and buying capital equipment. Crucially, though, they only do so if they think the increase in consumption is likely to be permanent.

At the start of 2013, it was hard to see why consumer spending would rise. The economy had recorded little growth for two years and confidence was low. Inflation had been higher than earnings growth during 2012, making it hard for families to manage.

Three factors combined to change the picture: cheap credit, the Bank of England's funding for lending scheme (FLS), and rising consumer confidence. The Bank of England cut its official interest rate to 0.5% in early 2009, but it took a long time for the monetary stimulus to have an impact.

It only really did so when FLS was announced in the summer of 2012. This was a deal under which the commercial (high street) banks could borrow more cheaply from the Bank of England provided they passed on the benefits to their customers.

The idea was that household and business borrowers would benefit: loans would become more readily available and the interest rates charged on them would be lower. Lending to businesses was disappointing, but the impact on the mortgage market was rapid and significant: more mortgages were approved, and at lower rates of interest. This contributed to the improvement in the housing market, which in turn boosted confidence, leading to higher spending, and this led to higher growth.

Consumers ran down their savings to fund this higher spending. Again, this is not unusual. Households become more cautious in troubled times and they save more just to be on the safe side.

However, unless consumers are willing to save less and less and borrow more and more, there is only so long this process can continue. Eventually, consumer spending growth has to be the result of rising real incomes rather than falling savings.

After a year in which the consumer has been the driving force behind the expansion of the economy, 2014 should be the year when investment contributes to growth. Many of the conditions for an increase in business spending are in place: companies are cash rich, profitability is good, interest rates are set to stay low, and ageing capital stock needs replacing.

The one factor not in place is the most important one of all: an increase in real wages. If companies believe that consumers will carry on spending, they are much more likely to go ahead with new investment projects. If they think consumer spending will not increase, then they will be unwilling to invest. This will mean that inflationary pressures build up and the trade deficit will continue to widen.

(Source: adapted from 'Why Britain needs a pay rise', Larry Elliott, *The Guardian*, 29 December 2013 http://www.theguardian.com/money/2013/dec/29/why-britain-needs-pay-rise)

(c) With reference to Extract A, explain **two** reasons why consumer spending rose in 2013.

(6)

(d) Assess the importance of interest rates in determining the level of business investment in the UK.

(10)

(e) Discuss the likely impact of both a lack of new investment and an appreciation of the British pound (£) on 'inflationary pressures' in the UK (Extract A line 36).

(15)

EITHER

(f) Evaluate whether the UK government should focus on achieving economic growth as its key macroeconomic objective.

(20)

OR

(g) Evaluate the use of monetary policy to achieve the UK's macroeconomic objectives.

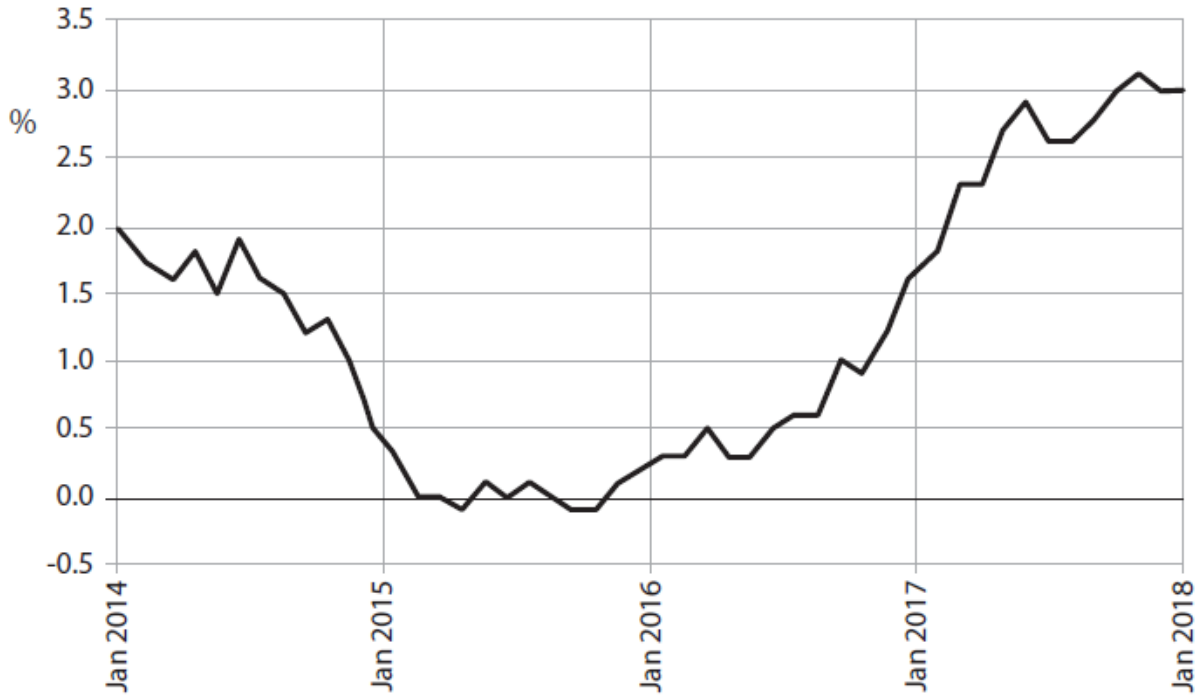
(20)

(Total for question = 60 marks)

Q4.

UK inflation and economic growth

Figure 1: UK inflation rate as measured by annual percentage changes in the Consumer Price Index (CPI), January 2014 to January 2018



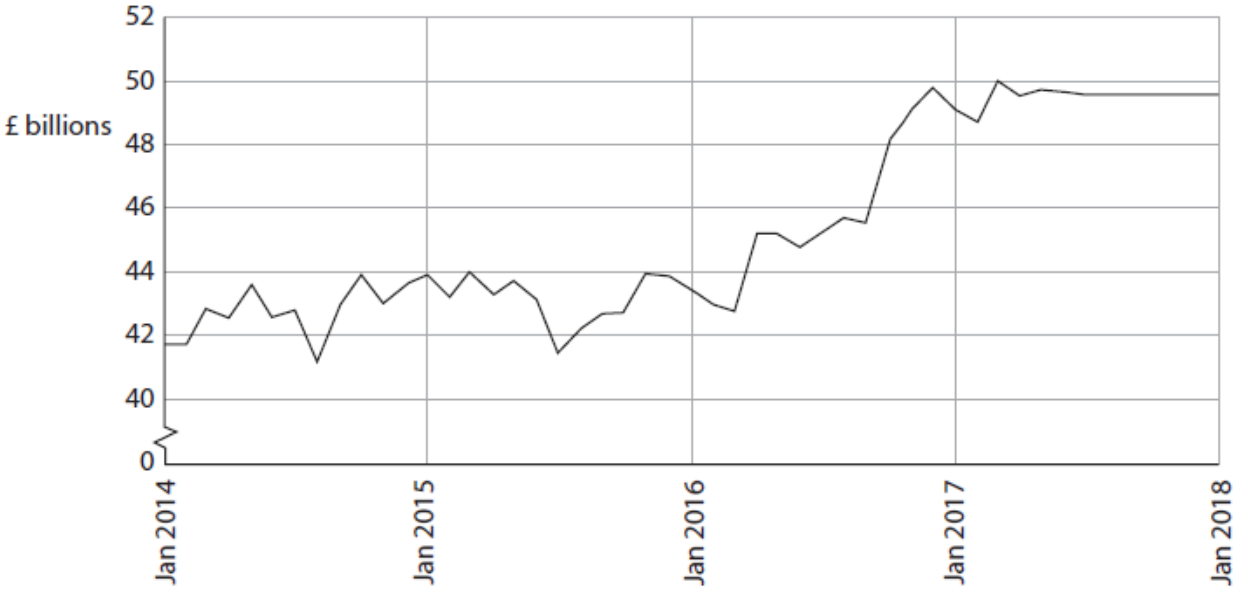
(Source: www.bankofengland.co.uk/publications/Pages/inflationreport/2017/aug.aspx)

Figure 2: Selected changes to the CPI basket of goods and services, 2017

IN	OUT
Non-dairy milk	Apple cider
Jigsaw puzzles	Menthol cigarettes
Child scooters	Child swings
Cycling helmets	Basic mobile phones

(Source: www.theguardian.com/business/2017/mar/14/uk-inflation-ons-basket-goods-gin-cycling-helmets)

Figure 3: UK exports, £ billions per month, January 2014 to January 2018



(Source: Trading Economics, ONS - https://tradingeconomics.com/united-kingdom/exports)

Figure 4: Annual percentage change in real Gross Domestic Product (GDP), 2014-2017

	2014	2015	2016	2017
United Kingdom	3.1	2.2	1.8	2.0
Developing countries (average)	4.7	4.2	4.1	4.5

(Source: IMF, World Economic Outlook 2017)

Extract A

Rising inflation

After January 2017, the inflation rate, as measured by the Consumer Price Index (CPI), in the UK has exceeded the Bank of England's 2% target. Sharp increases in food prices as a result of the fall in the exchange rate of the pound have contributed to rising inflation. Between January and September 2017, food prices have increased by 3.5 percentage points.

The Office for National Statistics (ONS) has identified that the rapid increase in food prices affected people on low fixed incomes the most. It leaves them with very little money to spend on relatively more expensive items. Moreover, the Bank of England has observed a rise in the size of personal debt relative to income. In order to maintain their standard of living, many consumers on low fixed incomes are using their credit cards and taking out short-term loans to fund their spending.

Inflation rose to over 3% at the end of 2017 leading to the Monetary Policy Committee increasing the base rate of interest by 0.25 percentage points to 0.5% in November 2017. Wage growth has been lagging behind price rises and this is expected to continue. Basic wage increases are expected to be only around 1%. This has heaped considerable pressure on households.

The ONS has updated the shopping basket that is used in the measurement of UK inflation, to reflect the lifestyle of households in the country. Technological advancements, changes in consumer tastes and a move towards health, fitness and gluten-free products have made it essential to revise the 2017 basket.

(Source: adapted from 'UK inflation tipped to rise again with wages forecast to stagnate', The Guardian, https://www.theguardian.com/business/2017/aug/13/uk-inflation-tipped-to-rise-again-with-wages-forecast-to-stagnate#img-1)

Extract B

Economic growth and living standards

Economic growth is expected to accelerate again as foreign demand for UK exports increases due to the global economic recovery. According to some economists, consumer spending is no longer the engine of growth for the UK. The increase in exports, which is largely due to the fall in the exchange rate of the pound, is expected to be the most significant driver of the UK's economic growth.

Some economists have proposed that the quality of economic growth needs to be measured and not just the quantity. This will allow governments to understand how GDP growth affects the living standards of its citizens. They want governments to publish data on the quality of life alongside GDP data as economic growth varies across the country with jobs and wages distributed unevenly. Economic growth figures also hide differences that are not considered in GDP calculations. In 2017, it was estimated that the relative size of the informal economy of developing countries was nearly five times greater than that of the UK.

(Source: adapted from 'Growth to accelerate as UK economy bounces back', The Telegraph, http://www.telegraph.co.uk /business/2017/08/01/growth-accelerate-uk-economy-bounces-back/; 'GDP is not enough: economists and businesses demand new measure of inclusive growth', The Telegraph, http://www.telegraph.co.uk/business/2017/03/07/gdp-not-enough-economists-businesses-demand-new-measure-inclusive/)

(a) With reference to the first paragraph of Extract A and Figure 1, explain how the change in the exchange rate of the pound has 'contributed to rising inflation' (Extract A, line 4).

(4)

(b) With reference to Extract A, explain **two** likely economic effects of the higher rate of UK inflation.

(6)

(c) With reference to the last paragraph of Extract A and Figure 2, explain **one** reason why it is necessary to regularly update the CPI basket of goods and services.

(5)

(d) With reference to Figure 3, assess the likely impact of the change in the value of exports, since mid-2016, on the economic growth of the UK. Use an aggregate demand and aggregate supply diagram in your answer.

(10)

(e) With reference to Figure 4, Extract B and your own knowledge, discuss the limitations of using GDP data to compare living standards between the UK and developing countries.

(15)

EITHER

(f) Evaluate the use of interest rate changes as a means of controlling UK inflation.

(20)

OR

(g) Evaluate the potential conflicts between the objective of economic growth and **two** other UK macroeconomic objectives.

(20)

(Total for question = 60 marks)

Q5.

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

(a) Illustrate the shape of the Keynesian long-run AS curve on the diagram below.

(1)



(b) Explain what is meant by spare capacity in an economy.

(2)

.....

.....

.....

.....

.....

.....

.....

.....

(c) Which **one** of the following is most likely to cause a movement along the AS curve?

Changes in:

(1)

☒ **A** competition policy

☒ **B** relative productivity

☒ **C** the cost of raw materials

☒ **D** the level of aggregate demand

(Total for question = 4 marks)

Q6.

In 2011, the Bank of England estimated that the marginal propensity to consume for UK households was on average 0.4.

(Source: http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb110402.pdf)

(a) Define the term 'marginal propensity to consume'.

(1)

.....

.....

(b) Calculate the value of the multiplier for the UK in 2011. You are advised to show your working.

(2)

.....

.....

.....

.....

(c) Which **one** of the following is a likely cause of an increase in the value of an economy's multiplier?

(1)

A An increase in the marginal propensity to save

B An increase in the basic rate of income tax in the economy

C A decrease in the marginal propensity to import

D A decrease in investment in the economy

Answer ☐

(Total for question = 4 marks)

Q7.

(a) Define the term 'productivity'.

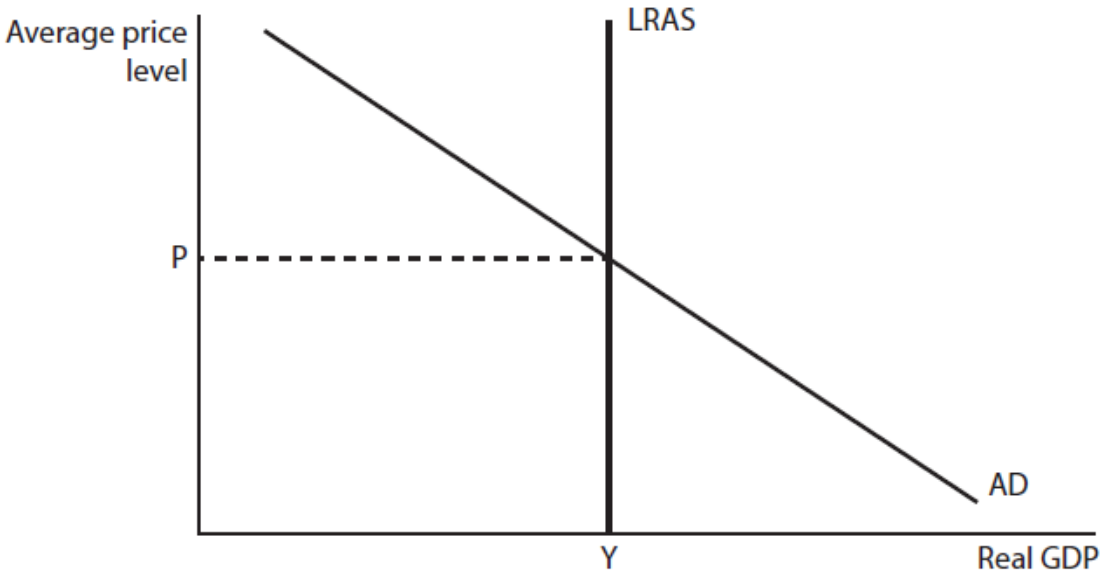
(1)

.....

.....

(b) Using a classic long-run AS curve, annotate the diagram below to show the effect of an increase in productivity on the equilibrium level of real national output and the average price level of the economy.

(2)



(c) Which **one** of the following statements is correct?

(1)

A The Keynesian long-run AS curve implies that an economy may have a negative output gap in the long run

B The Keynesian long-run AS curve is perfectly inelastic at all levels of real national output

C The classic long-run AS curve implies that an economy may have spare capacity in the long run

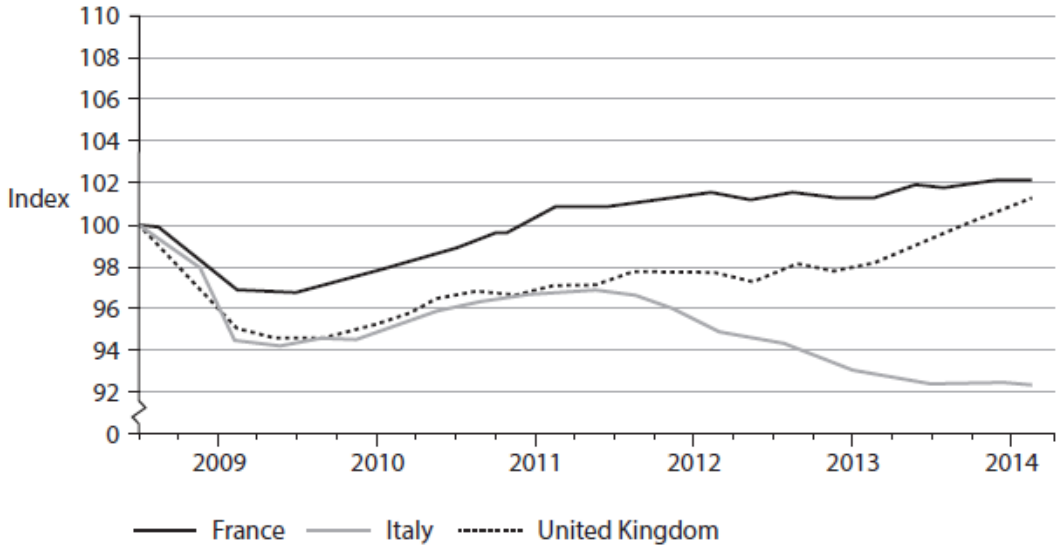
D The classical long-run AS curve is perfectly elastic at all levels of real national output

Answer

(Total for question = 4 marks)

Q8.

Real GDP in selected economies (the base year 2008=100)



(Source: http://www.ons.gov.uk/ons/rel/elmr/gdp-and-the-labour-market/q1-2014--may-gdp-update/sty-gdp-g7-economies.html?format=print)

(a) Which **one** of the following can be inferred from the chart?

(1)

☒ **A** The UK's real GDP is smaller in 2014 than it was in 2008

☒ **B** Between 2008 and 2014 France's real GDP growth rate was higher than Italy's

☒ **C** Between 2008 and 2014 inflation was lower in France than in the UK

☒ **D** France experienced a greater fall in real GDP than the UK in 2014

(b) Define the term 'real GDP'.

(2)

.....

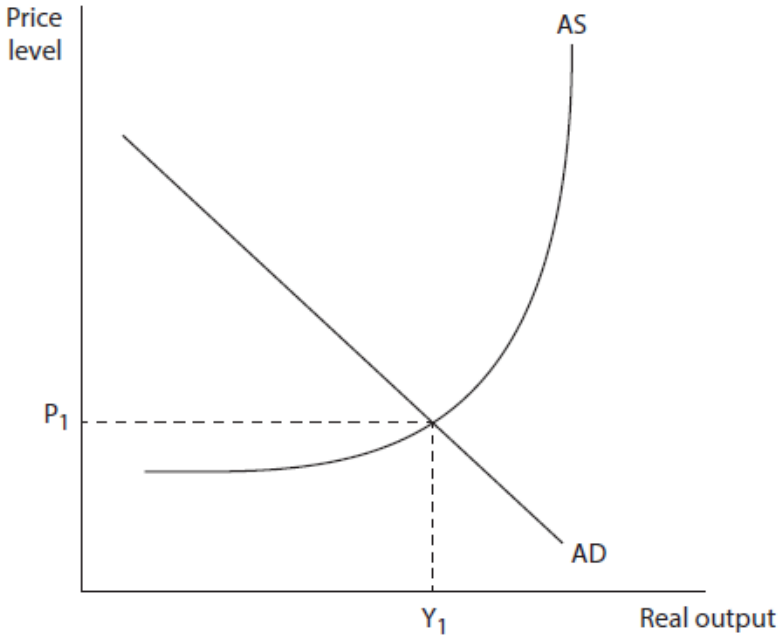
.....

.....

.....

(c) Illustrate a negative output gap on the diagram below.

(1)



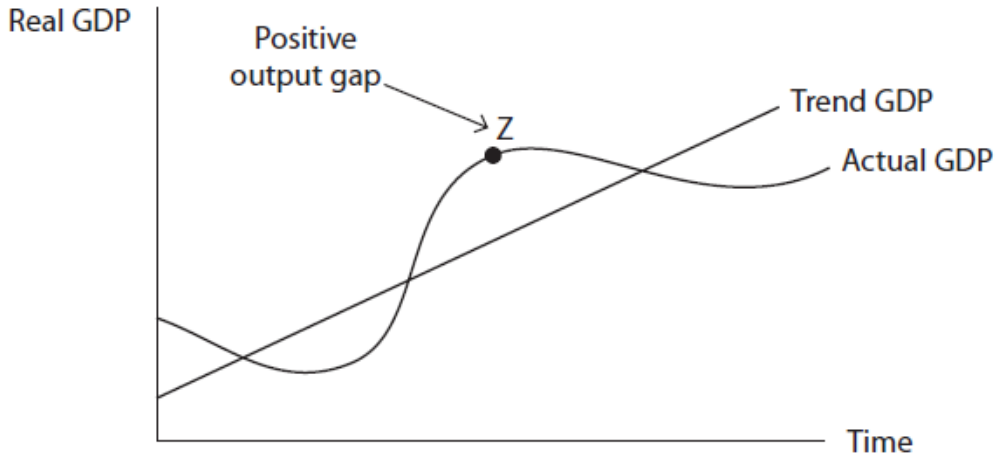
(Total for question = 4 marks)

Q9.

Some questions must be answered with a cross in a box (☒). If you change your mind about an answer, put a line through the box (☒) and then mark your new answer with a cross (☒).

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

The trade cycle



(a) At point Z on the diagram, which **one** of the following is likely to occur?

An increase in:

(1)

☒ **A** absolute poverty

☒ **B** budget deficit

☒ **C** cyclical unemployment

☒ **D** inflation

(b) With reference to the graph, explain the difference between automatic stabilisers and discretionary fiscal policy.

(4)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

(Total for question = 5 marks)

Q10.

(a) Define the term 'recession'.

(1)

.....

.....

.....

(b) Explain **one** characteristic of a recession.

(2)

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

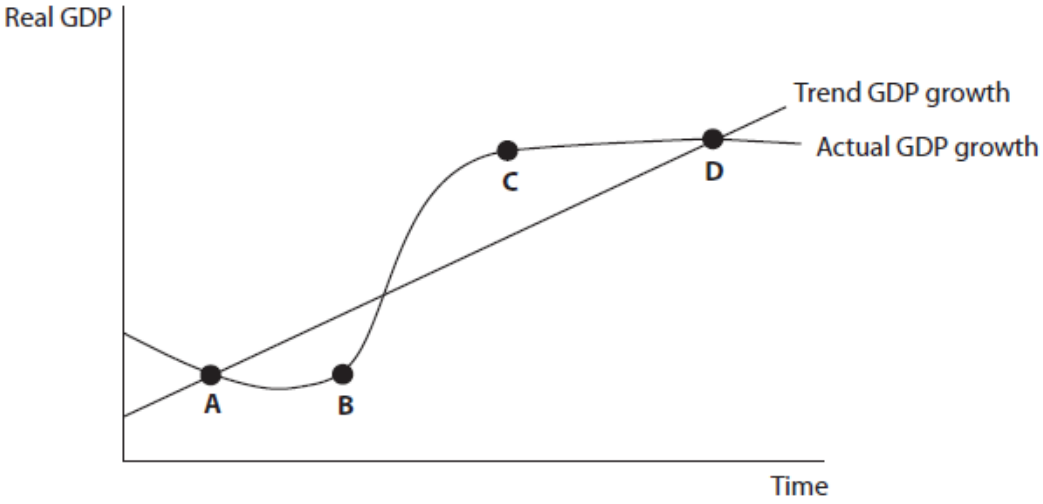
.....

.....

.....

(c) Which point on the trade cycle diagram illustrates a negative output gap?

(1)



☒ **A**

☒ **B**

☒ **C**

☒ **D**

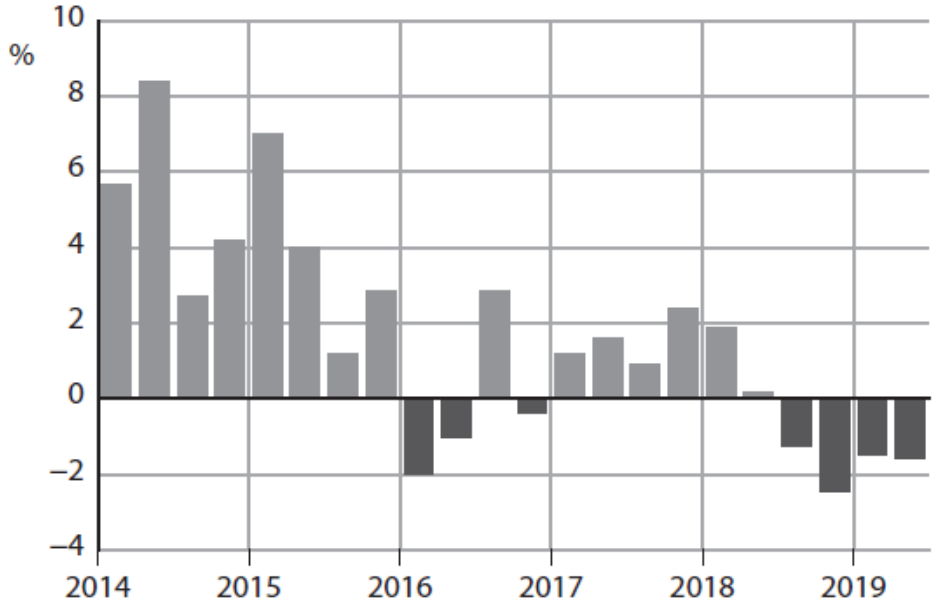
(Total for question = 4 marks)

Q11.

Read Figures 1 and 2 below and Extract A before answering this question.

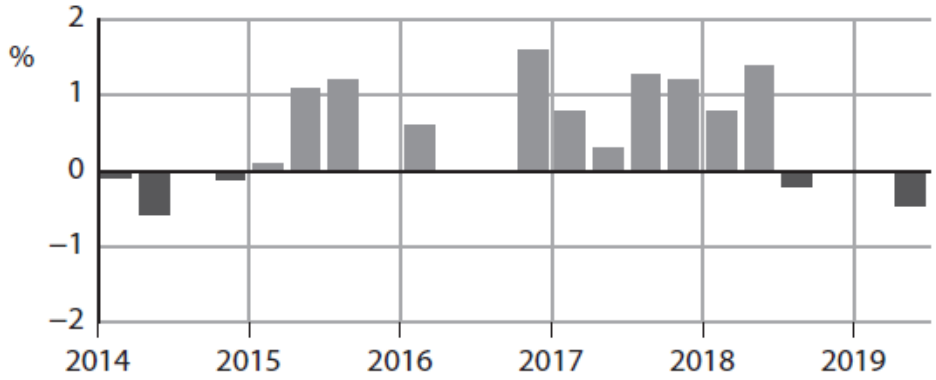
UK investment and productivity

Figure 1: UK investment, annual percentage change, 2014 to 2019



(Source adapted from: https://www.ft.com/content/5e12351e-baaf-11e9-96bd-8e884d3ea203)

Figure 2: UK labour productivity, annual percentage change, 2014 to 2019



(Source adapted from: https://www.theguardian.com/business/2019/oct/08/uk-productivity-brexit-boris-johnson-labour)

Extract A

Another recession?

For the first time in nearly seven years, the UK economy contracted by 0.2% in the second quarter of 2019. This was as a result of a significantly weaker than expected performance in almost every part of the UK economy.

Business investment has been weak across the world, but it is particularly low in the UK. Firms are reluctant to commit to capital spending while there is economic uncertainty. Growth in investment, in areas such as transport and machinery, has slowed. Global trade tensions are also affecting investment decisions.

Labour productivity decreased by 0.5% in the second quarter of 2019, the worst performance since mid-2014. Declining productivity is a concern especially as it comes at a time when the unemployment rate has been one of the lowest. The rate of unemployment decreased from 6% in July 2014 to 3.8% in July 2019.

The UK's economic growth has been held back by low investment and productivity since the Global Financial Crisis of 2008. Moreover, the uncertainty over the UK's future trade relationship with the EU has discouraged companies from investing in productivity-boosting technology. This has decreased the prospects for increases in workers' pay. Without business investment and improvements in productivity, short-term growth in real GDP is likely to slow further and reduce living standards.

However, the UK Government expects the UK economy to perform better than Germany and Italy. These export-focused countries are highly exposed to the slowdown in world trade and the fall in average global incomes.

The UK economy is seeing continued strength in consumer spending. Consumption will support growth, provided there is no sudden shock to the UK labour market. Household incomes are strong, primarily due to high employment. Government expenditure has also been rising since the end of 2018. The UK Government has promised more money for schools and infrastructure improvements.

Despite this, some economists believe that the UK economy is likely to experience another recession. They claim that low income households cannot cope with a new downturn. The overall picture for the UK economy does not look promising because most businesses are reluctant to invest, productivity is low and economic growth relies on continued consumption.

(Source adapted from: 'On the brink: Britain's economy braced for Brexit shock', FT, https://www.ft.com/ content/40c604d2-c01c-11e9-89e2-41e555e96722; 'Recession threat hangs over UK economy ahead of Brexit, FT, https://www.ft.com/content/5e12351e-baaf-11e9-96bd-8e884d3ea203; 'UK productivity falls at fastest pace in five years as Brexit dents investment, The Guardian, https://www.theguardian.com/ business/2019/oct/08/uk-productivity-brexit-boris-johnson-labour)

(a) With reference to Figure 1, explain the term 'investment'.

(4)

(b) With reference to Extract A, explain **two** influences on the level of UK investment.

(6)

(c) With reference to the fourth paragraph of Extract A, assess the limitations of using GDP to compare living standards over time.

(10)

(d) Explain **one** likely reason why 'the UK Government expects the UK economy to perform better than Germany and Italy' (Extract A, lines 19–20).

(5)

(e) With reference to the information provided, discuss the likely impact of a recession on the UK economy.

(15)

EITHER

(f) Evaluate the fiscal policies the UK Government could use if it believes that 'the UK economy is likely to experience another recession' (Extract A, lines 27–28).

(20)

OR

(g) Evaluate the supply-side policies the UK Government could use to increase the UK's productivity.

(20)

(Total for question = 60 marks)