

Data Response Case Studies

Theme 2: The wider economic environment

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Teacher's Introduction

The case studies in this series are designed to support students as they study the A Level Economics Edexcel B module *Theme 2: The wider economic environment*. These case studies cover the Edexcel B specification perfectly, and are designed as real-world contexts to complement the theoretical content of the module.

Remember!

Always check the exam board website for new information, including changes to the specification and sample assessment material.

Each of the 13 case studies contains:

- * **Contextual information:** this is the body text of the case studies, providing the relevant information, facts and figures.
- * **Data:** data presented in a graphical format.
- * **Use the data questions:** students are presented with questions set in response to the data presented. Answers are included.
- * **Test your knowledge questions:** students are presented with questions designed to mimic short-answer examination questions. Answers are included.
- * **Extended-response question:** students are presented with a question designed to mimic long-answer examination questions. Possible answers are included in summary form.

This resource is designed to be useful to students of all abilities. Students of the highest ability require up-to-date contextual information for use in examination, while for lower-ability students these case studies may complement class activity and help to ground theoretical content in real-world contexts.

These case studies are designed to be up to date for 2023 and provide as contemporary a snapshot of economic discussion as possible. However, it is likely that some themes which are relevant and topical at the time of teaching may not be included. It is therefore advised that these examples are used in tandem with the study of the most recent themes.

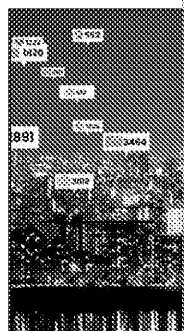
I hope this resource can contribute towards an engaging and rewarding learning environment. Best of luck with your teaching!

May 2023

Growth through acquisition: Facebook's mar

2.1 Business growth and competitive advantage

Facebook is the world's third most visited website, and the biggest social network. It outmanoeuvred market rivals such as MySpace and Friendster in the late 2000s to establish a monopoly position in the social network scene. But the key to maintaining its market position in the 2010s, when faced with emerging and established competition, has been two enormous acquisitions.

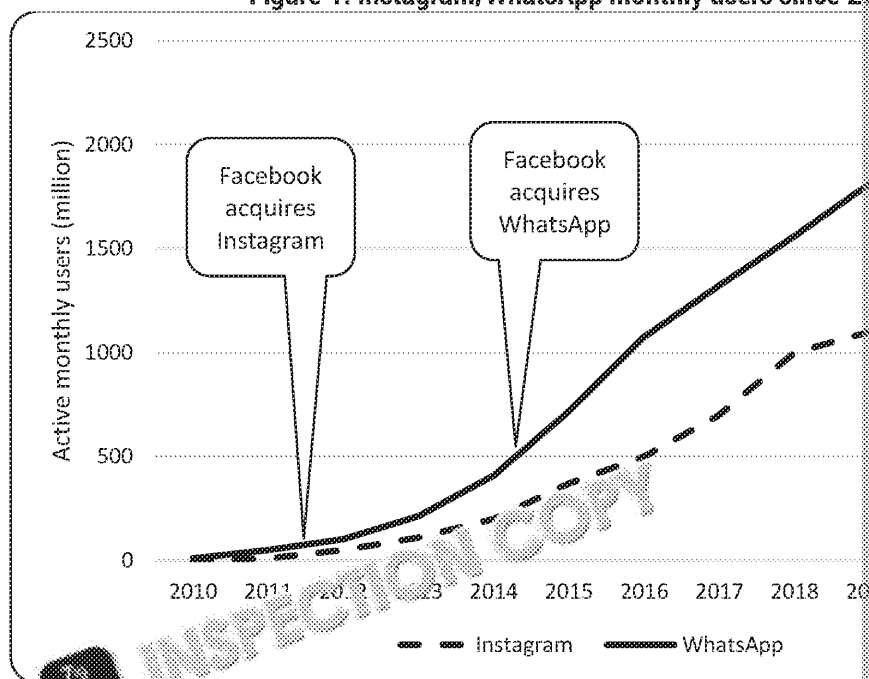


In 2012, Facebook purchased Instagram for the seemingly astronomical sum of \$1 billion. The move was widely viewed as a catastrophic overvaluation by some, but CEO Mark Zuckerberg. When purchased, Instagram had only 13 employees and less than 50 million unique users. This, at the time, was a regular user base for a billion-dollar company.

In 2014, Facebook purchased WhatsApp for the even more staggering sum of \$19 billion (the entire GDP of Iceland). The deal was viewed as make or break for Facebook – it was successful.

Both of the acquisitions were extremely well timed, and more than good value for money. WhatsApp brings in more than \$5 billion a year for Facebook, while Instagram brings in a stunning \$20 billion. This demonstrates the huge growth of both platforms, which mostly took place after their acquisition.

Figure 1: Instagram/WhatsApp monthly users since 2010



The savvy acquisitions have maintained Facebook's dominance of the social media market, particularly among younger generations, during a period in which the primary product's growth among them had begun to slow. It also prevented the emergence of key rivals, and thus maintained its market position. For example, Google+, a social network launched by the online search giant in 2011 to compete with Facebook, was closed in 2019.

¹ <https://www.businessofapps.com/data/whatsapp-statistics/> and <https://www.demandsage.com/instagram-statistics/>

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In 2017, Facebook introduced the 'stories' feature across its platforms in a direct bid to compete with Snapchat, which it failed to acquire in 2013. The introduction of the 'reels' feature across its platforms was another attempt to halt the growth of TikTok, which has experienced rapid expansion among young people.

While Facebook continues to grow, its acquisitions are catching up quickly. Figure 2 shows the number of active monthly users of Facebook, WhatsApp and Instagram in 2022.

Figure 2: Monthly users of Facebook platforms in 2022



Use the data

- Using Figure 1, calculate the percentage change in WhatsApp's monthly active users from 2017 to 2022.
- Figure 2 demonstrates the scale of Facebook's reach. Explain why this scale of reach is a key feature of Facebook's business model.

Test your knowledge...

- Explain the term 'horizontal integration' in the context of Facebook.
- Explain which business objective Facebook was pursuing in 2012, and why.

Extended-response question

- Assess the costs and benefits of business growth.

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Growth through demergers: Walmart breaks

2.1 Business growth and competitive advantage

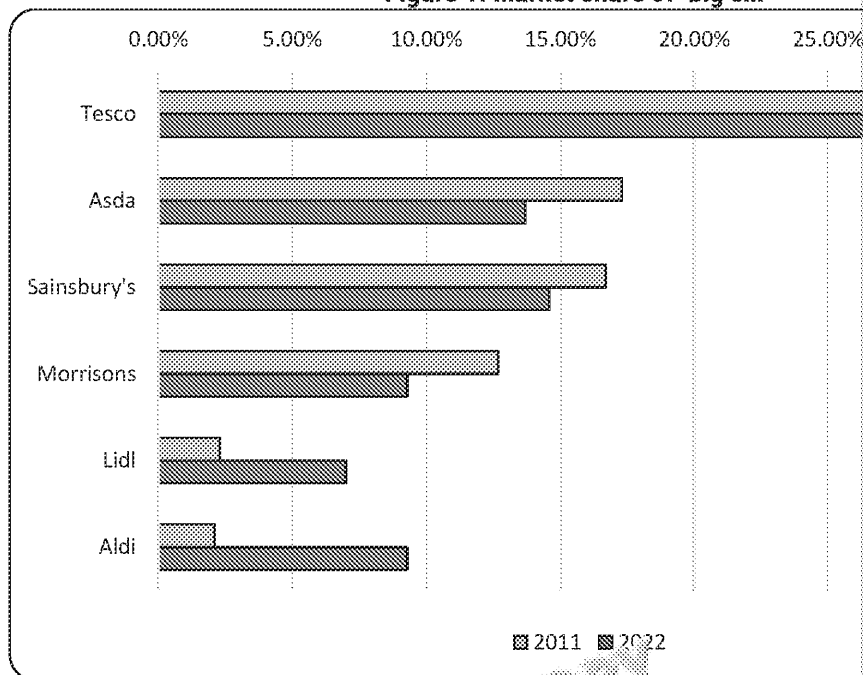


Business growth does not always in order to expand, firms need to be inefficient or subject to an internal example of this dynamic at work is a merger which has not performed

For an example of a major demerger of Asda in 2021. Walmart – one of the largest Asda in 1999 in order to enter Asda was the UK's second largest share, and the acquisition cost Wa

Walmart occupied a dominant position in the global retail market, and its purchase of the industry was seen as an attempt to become the UK's market leader. However market share under Walmart's tenure, instead gradually slipping into third place in the Figure 1 shows the market share of the six major supermarkets in 2011 and 2022.

Figure 1: Market share of 'big six' ²



Though largely maintaining Asda's position in the market is hardly a failure, it fell well short of the store. Walmart's business model in the USA has been to open out-of-town mega stores that undercut rivals on price. However, the UK is less suited to the out-of-town model than the USA, and Walmart struggled to undercut the low prices of German discounters Aldi and Lidl.

Walmart – used to exerting market dominance – ultimately struggled to expand its market share in the regulated and highly competitive UK supermarket industry. The megabrand has had success in markets with fewer regulations and less established rivals. Figure 2 shows where Walmart was concentrated in 2021, demonstrating that Asda was a relatively small part of the company's global operations.

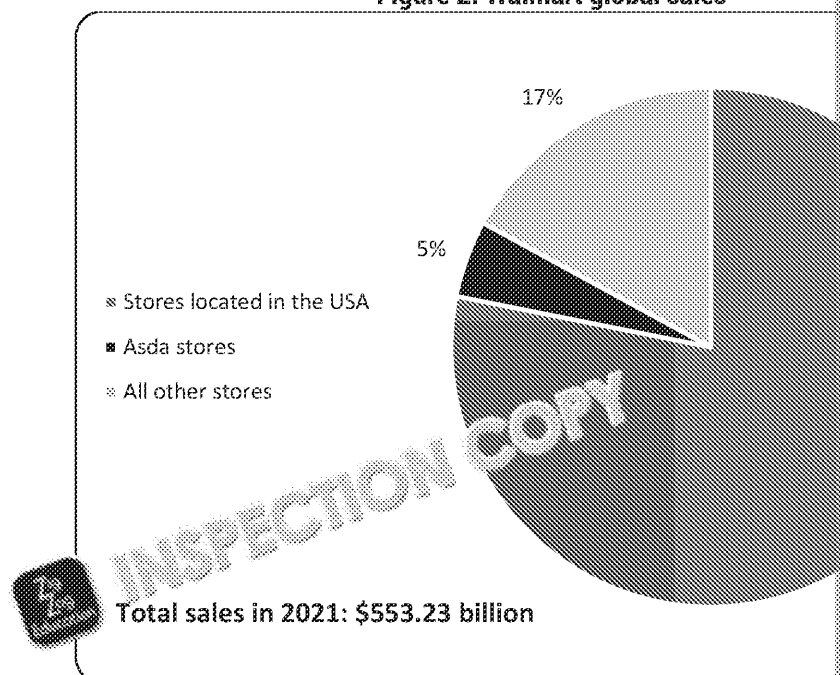
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² <https://www.kantar.com/campaigns/grocery-market-share>

Figure 2: Walmart global sales ³



In 2018, Asda and Sainsbury's entered formal negotiations over a possible merger, which would have conglomerated the UK's largest supermarket. The proposal was strongly favoured by the competition regulator, who argued that the merger would lead to higher prices for competition for retailers.

In 2021, Walmart sold Asda to for £6.8 billion – only marginally more than the price paid in 2006. The deal was seen as mutually beneficial. It allowed Walmart to exit the UK market where its new owners are considered more committed to competing in the UK marketplace on its own terms.

Use the data

1. If the merger had been approved in 2018, what would have been Asda–Sainsbury's market share?
2. Using Figure 2, calculate Asda's total sales in 2021.

Test your knowledge...

1. Using a demand and supply diagram, explain the effect of a decline in Asda's sales since 2011.
2. Demand is generally assumed to increase competition in the market, which leads to lower prices for consumers. Explain whether this is the case with Walmart and Asda.

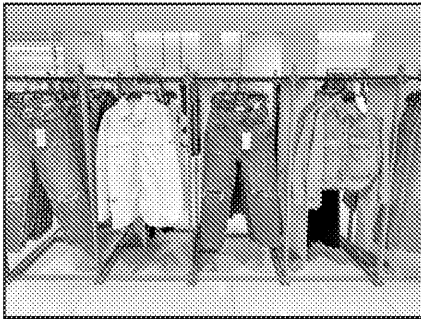
Extended-response question

1. Assess whether horizontal or vertical integration is likely to be more beneficial for the welfare of a firm.

³ <https://dazeinfo.com/2020/07/16/walmart-annual-revenue-by-region-graphfarm/>

Shifting markets: Changing trends in fashion retail

2.2 Firms, consumers and elasticities of demand

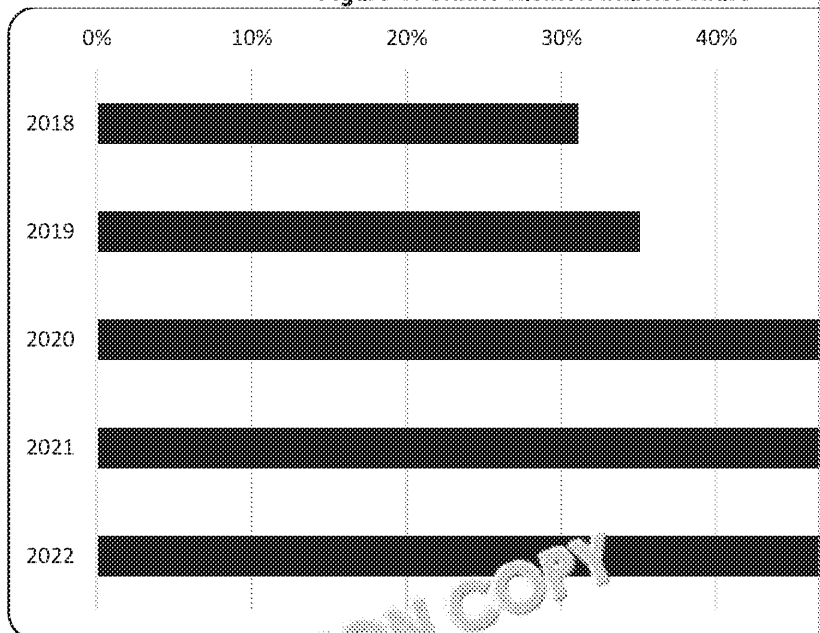


In November 2020 the Arcadia Group filed for administration. The Group owned a number of major UK retail clothing brands, including Topshop, Burton and Dorothy Perkins. It was one of the largest employers in the country with a workforce of 13,000. The firm's collapse was due to a combination of pandemic restrictions on the profitability of the retail sector, the collapse, though it had been struggling for years before the pandemic. Business rates and changing consumer trends had reported huge losses of millions of pounds over several hundred stores.

While external factors no doubt played a major role in the collapse, the Arcadia Group also came under intense public scrutiny for its running of the business. Green's business was characterised by heavy investment in his stores. He has also been accused of fatally missing the shift to online in the industry, spending millions on expanding and maintaining his commercial property portfolio in urban areas at the expense of focusing on the burgeoning online retail market. In addition, his business – including tax avoidance and alleged abuse of staff – has been viewed as undermining the retail sector.

While Arcadia doubled down on bricks-and-mortar stores, the online fashion market grew its market share of online platforms as a percentage of total clothing sales in the UK.

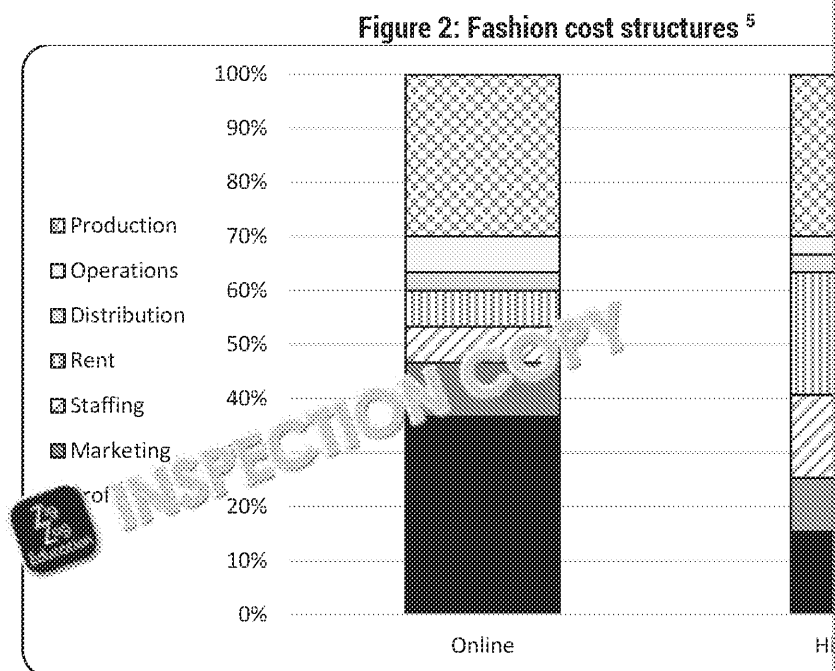
Figure 1: Online fashion market share ⁴



ASOS and Boohoo are now two of the UK's most popular online retailers, currently holding a combined market share of over 10%. In 2021 both companies made significant acquisitions. ASOS acquired the Arcadia Group's leading brands, including Topshop and Miss Selfridge, for a sum of £1.1 billion. Later Boohoo acquired three further Arcadia brands – Dorothy Perkins, Wallis and Denham, and store Debenhams, for a total of £80 million.

⁴ Source adapted from https://globalcitylogistics.org/?page_id=419

The cost structures in Figure 2 go some way to explaining why online retail has been high street.



All of these acquisitions focused on the purchase of the intellectual property associated with the brand rather than the rescue of their high-street operations. The purchase of these leading brands has become a key point in the business strategies of both online retailers, which had previously been characterised by organic growth.

Use the data

- Using Figure 2, calculate the percentage difference, as a share of total revenue, between online retailer costs and high-street retailer costs.
- Explain **two** non-price benefits of the online retail model for business growth.

Test your knowledge...

- Explain what effect increasing prices will have on total revenue.
- Using a suitable diagram, explain the effect of an acquisition on a firm's cost structure.

Extended response question

- Evaluate whether adopting a strategy of inorganic growth will be of benefit to the online retail sector and Boohoo.

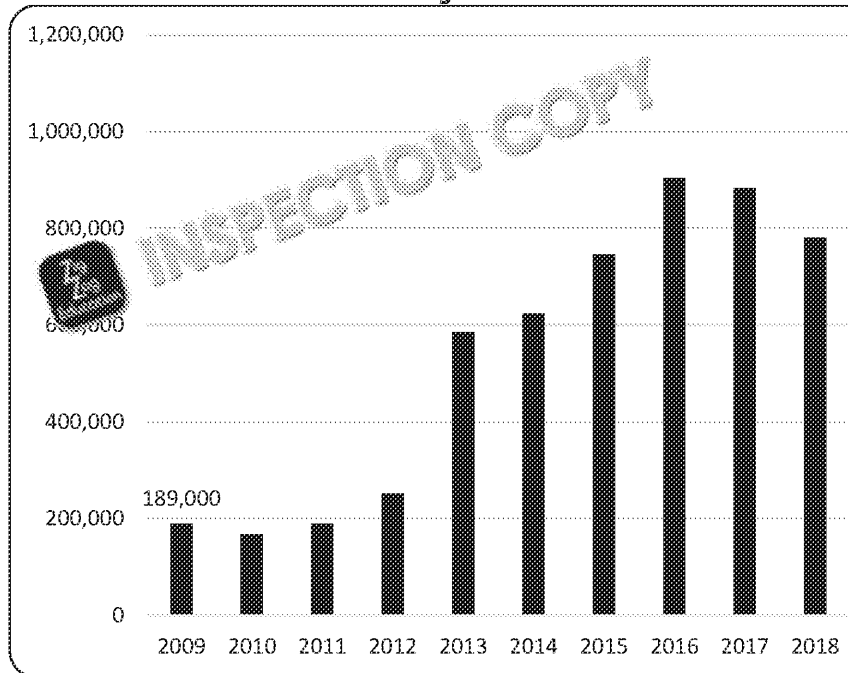
⁵ Adapted from: <https://www.grantthornton.co.uk/insights/has-ecommerce-put-the-high-street-out-of-fa-vorite>

Wage suppression and zero-hours contracts

2.3 Productive efficiency

Zero-hours contracts are employment contracts with no minimum guarantee of work. Since the 1990s, the use of zero-hours contracts has expanded over the last decade. In the use of such contracts – amounting to 3.2% of the workforce in 2022.

Figure 1: Zero-hour contracts



Zero-hours contracts are particularly prevalent in the hospitality and health and social care sectors. Workers can be called on or relinquished of duties depending on levels of demand. Critics, such as the Trades Union Congress, argue that the practice is exploitative and a leading cause of job insecurity, underemployment, and low wages. However, proponents of the practice disagree, highlighting the increased flexibility of the workforce.



Fast-food chain McDonald's is one of the biggest practitioners of zero-hours contracts, with over 80,000 of its workers employed on such a basis. In a series of trials offering employees the choice between a permanent or zero-hours contract, with 80% of workers choosing to remain employed on a permanent basis.

However, there is also evidence that workers on zero-hours contracts receive a lower wage than their colleagues with guaranteed hours. This may be contributing to the stagnation of wages in the low-wage sector because firms do not invest in training workers that are seen as more dispensable. Similarly, insecure workers may lack the time or motivation to develop their skills either through formal training or on-the-job learning.

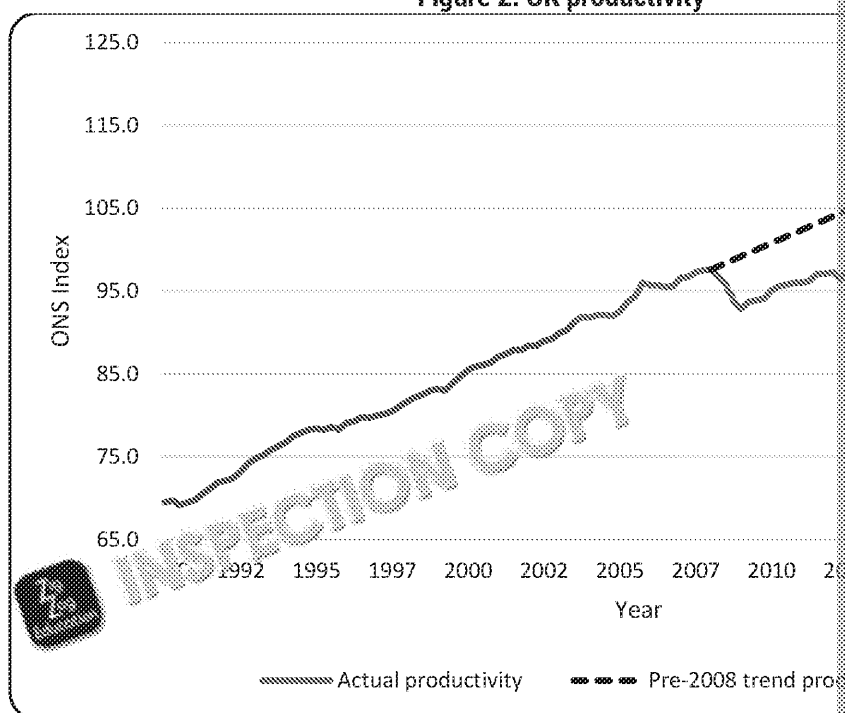
Along with flexible labour practices, the result is a growth in the insecure and underemployed workforce. The increased supply of unskilled labour places a downward pressure on wages in all sectors, leading to lower levels of productivity across the economy. Figure 2 shows that labour productivity has not fully recovered from the 2008 recession.

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Figure 2: UK productivity



Use the data

- Based on the passage and Figure 1, calculate the size of the UK workforce in 2008.
- Explain the likely elasticity of supply for labour in a low-skilled labour market.

Test your knowledge...

- Explain **two** reasons why workers at McDonald's might favour a zero-hours contract.
- Using a labour market diagram, explain the impact of rising productivity on the labour market.

Extended-response question

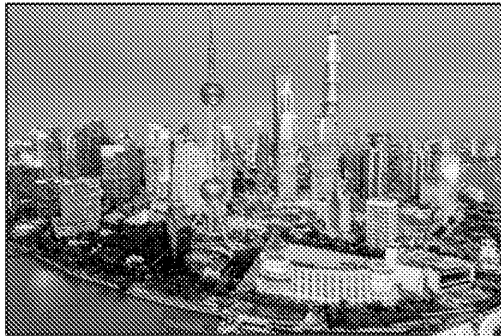
- Evaluate the extent to which banning zero-hours contracts could increase unemployment.

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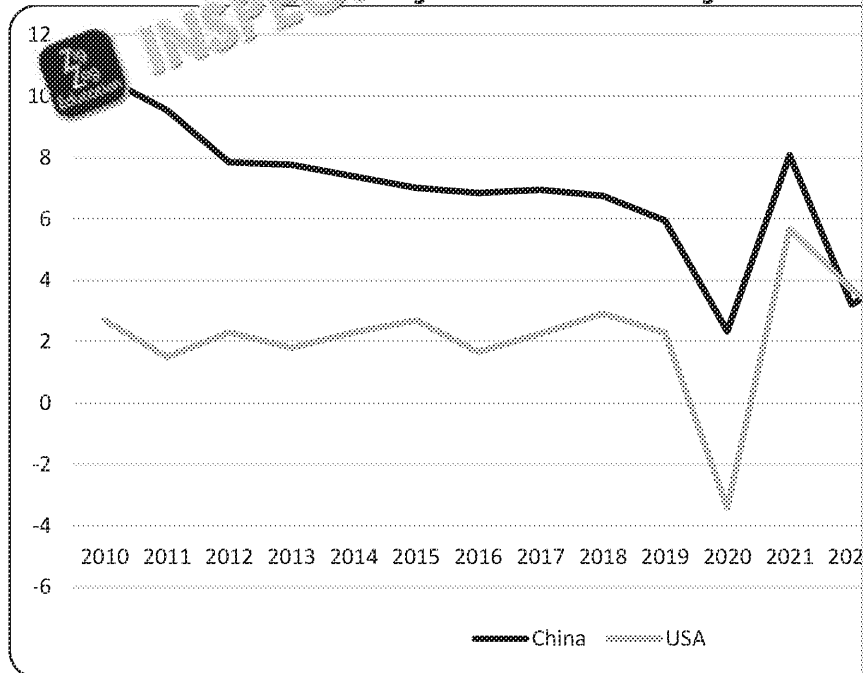
Developmental ambiguity: China at the

2.4 Life in a global economy



The growth of the Chinese economy has seen the East Asian superpower set to become the world's nominally largest economy by 2028. However, to avoid recession, instead experiencing slower growth than Chinese standards, but relatively improved standards in the Global North. The rates of China and the United States for growth projections until 2026.

Figure 1: US-China annual growth



By some measures of gross domestic product, however, China is already the world's largest economy when adjusted for local prices – known as Purchasing Power Parity, or PPP – China is comparable to the EU, and has been for many years. Some cite this as an example of China's economic success, which suggests the Chinese economy has contributed more to global growth than any other country.

Yet at the World Trade Organization, China continues to carry the status of a developing country, causing some consternation among Western developed economies. Some argue that China's rapid economic growth means it should give up advantages reserved for developing nations. However, other economies in the WTO are permitted to receive special and differential treatment provisions, such as longer time periods to implement trade commitments, such as the removal of tariffs. This is seen as a production-oriented model of growth, as it keeps their exports cheap.

Although economies seeking access to China's massive domestic market may view this as a disadvantage, which support China's claim of developing status. In global GDP per capita, for example, China is below Argentina and Mexico, and below the global average.

Aside from claiming developing status, Western leaders also argue that China engages in currency manipulation. They point towards the country's currency – the renminbi – which they argue is deliberately undervalued (overleaf) shows the US dollar value of a Chinese yuan since 1981.

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Figure 2: Value of yuan in \$



Use the data

- Using Figure 1, identify what happened in 2022 for the first time since 1976.
- What does Figure 2 suggest about China's exchange rate system?

Test your knowledge...

- Explain why China would deliberately devalue its currency.
- Explain **two** purposes of the World Trade Organization.

Extended-response question

- Evaluate whether the Chinese economy should still be considered developing.

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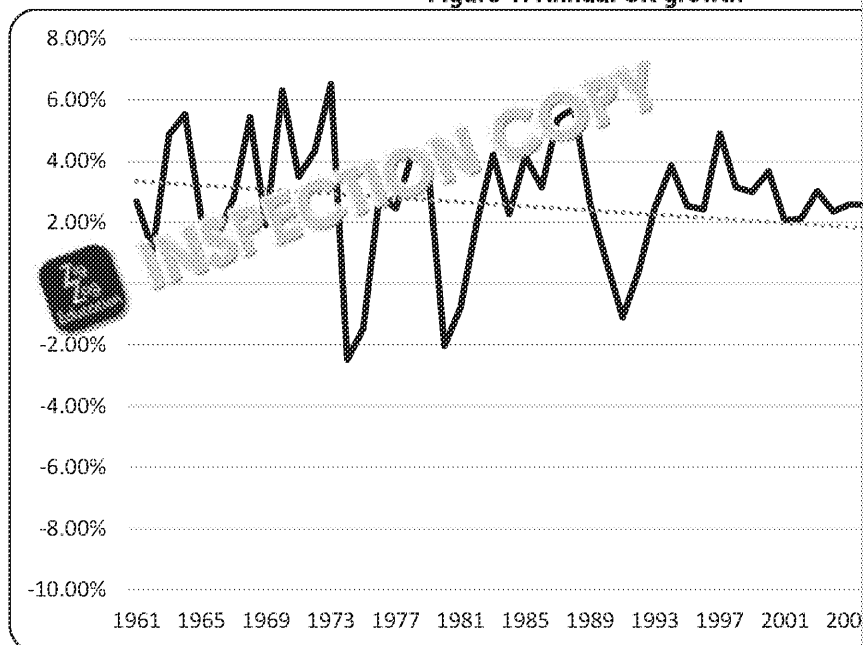


Economic growth: in permanent decline

2.5 The economic cycle

Perhaps the primary measurement of performance in macroeconomics is economic growth – the amount of economic activity that has taken place in an economy over a year, and the rate at which this activity is increasing. **Figure 1** shows the annual percentage of economic growth in the UK from 1961 to 2009.

Figure 1: Annual UK growth



Since the global financial crisis of 2007 to 2009, economic growth in the UK has remained very low. While historically gross domestic product would frequently exceed 3% growth over a year, this high has not been achieved since 2003 (with the exception of the post-pandemic recovery in 2020). During the 2010s, economic growth averaged out at just under 2%.

At the same time, the depth of recessionary periods has become more acute. By most measures, the UK's economy had not truly recovered from the financial crash before it was plunged into a deep recession by the coronavirus pandemic.

There are a number of possible reasons for these trends. Some economists argue that a lack of investment over the last decade has led to low levels of productivity, and therefore low economic growth. Others argue that the UK in particular has become more unequal in recent years, with high levels of consumption and suppressed growth.

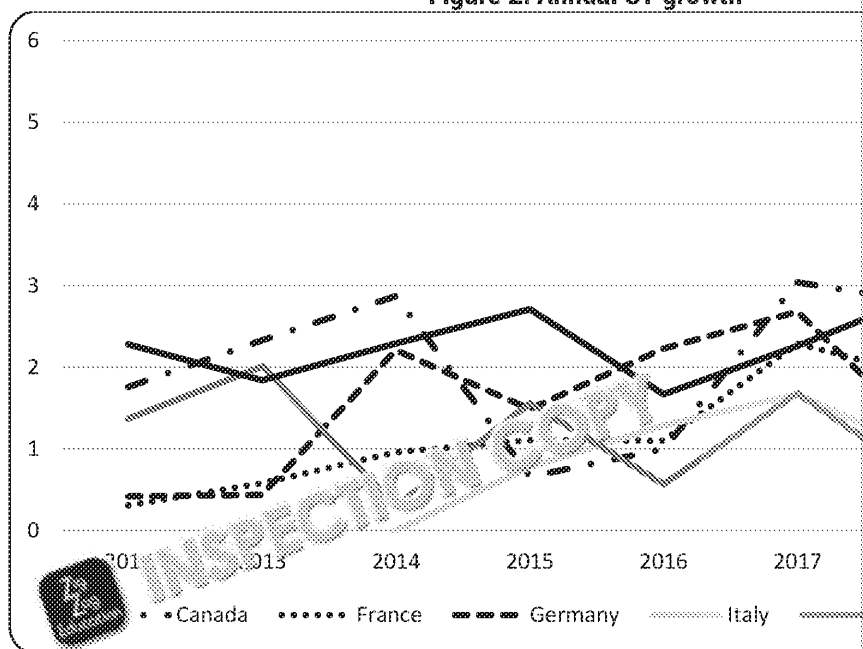
However, others still point out that the stagnation is not unique to the UK, and can be seen in many other economies. **Figure 2** (overleaf) shows the growth rates across the other G7 highly industrialised economies in 2012 and 2019 (before the coronavirus pandemic hit). It shows that economic growth was very low across the board in the years after the global financial crisis, and the UK – while not the best performer, was among the most sluggish.

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Figure 2: Annual G7 growth



Measuring and forecasting growth is key to making decisions on fiscal policy. Expansion is part of sustaining or resuming economic growth. However, critics argue that predicting growth is notoriously difficult, so basing spending decisions on forecasts is a risky move. This is especially true in a globalised economy, in which interconnected national economies are more vulnerable to economic contagion.

Use the data

1. Briefly describe how Figure 1 would change if nominal GDP figures were used instead of real GDP figures.
2. The UK's GDP in 2019 was \$2.83 trillion. The economy shrunk by 9% in 2020. What is the UK's GDP at the end of 2021?

Test your knowledge...

1. Explain real GDP.
2. Explain **two** alternative measures of economic growth, and how they differ from GDP.

Extended-response question

1. 'Once population size and inflation are accounted for, GDP is a good measure of how successful an economy is.' With reference to the UK economy, evaluate this statement.

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Inflation returns: rising prices in a slow

2.5 The economic cycle

Until the 2020s, inflation had become something of a historical phenomenon, associated with the 1970s. The 1990s, 2000s and 2010s had seen inflation brought down to manageable levels throughout much of the 2010s. Yet following the exogenous shock of the coronavirus pandemic and a spike in gas prices caused by the Russian invasion of Ukraine, inflation made a dramatic

Figure 1: UK inflation

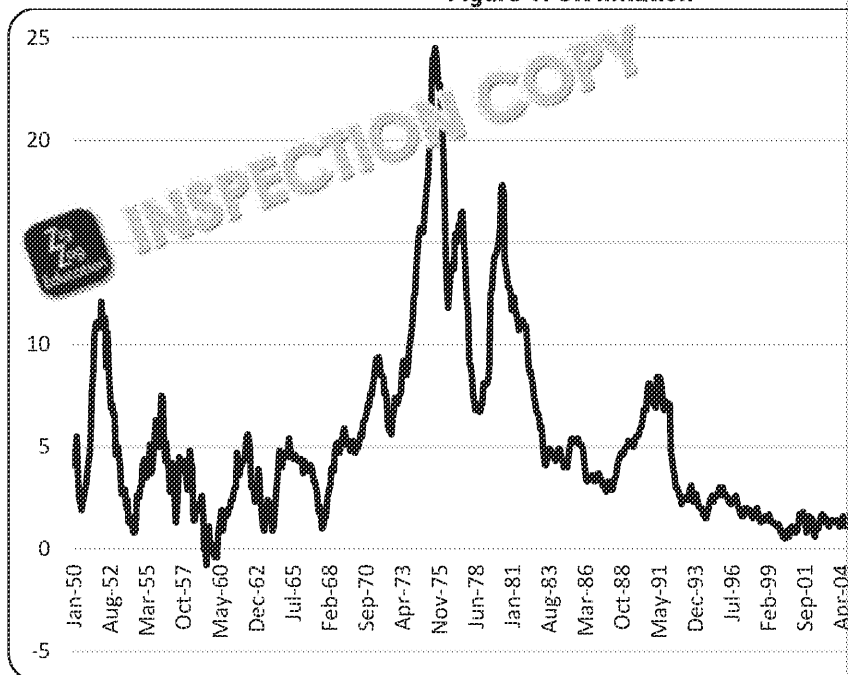


Figure 1 shows that in 2022 inflation exceeded 10% for the first time since 1981, according to the Consumer Price Index. The CPI measures a basket of everyday goods, such as groceries, clothing and housing, and the rate at which prices are increasing.

But the CPI is not the only measure used to capture inflation. The Retail Price Index (RPI) usually records a higher figure of inflation as it includes in its basket of goods the cost of mortgages, interest payments and council taxes. Therefore, while the CPI recorded an inflation rate of 10.1% in July 2022, the RPI measured inflation at 12.3%.

Under these circumstances, macroeconomic orthodoxy tells us to raise interest rates in order to stem rising inflation. However, rising interest rates have the effect of slowing demand across the economy. And if growth is already low, it can potentially trigger a recession.

This is precisely what happened on 4th August 2022, when the Bank of England announced that interest rates rise for the first time in 10 years – an increase of 0.5% – alongside gloomy predictions of a subsequent recession. By making this decision, the Bank is essentially prioritising reducing inflation over stimulating economic growth. This is a reversal of what had become the norm in macroeconomic policy: controlling inflation had become the main focus.

It is wise for policymakers to therefore be cautious when relying on measurements of inflation, as they can lead to highly damaging results across the economy.

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Use the data

1. Take a look at the trend between 1990 and 1994. Is this inflation, deflation or stagflation? Explain why.
2. In what year did the UK last experience deflation?

Test your knowledge...

1. Using a suitable diagram, explain what type of inflation is described in the paragraph.
2. Explain why the UK stopped using the Retail Price Index as its official measure of inflation.

Extended-response question

1. Assess the costs of inflation for an economy.

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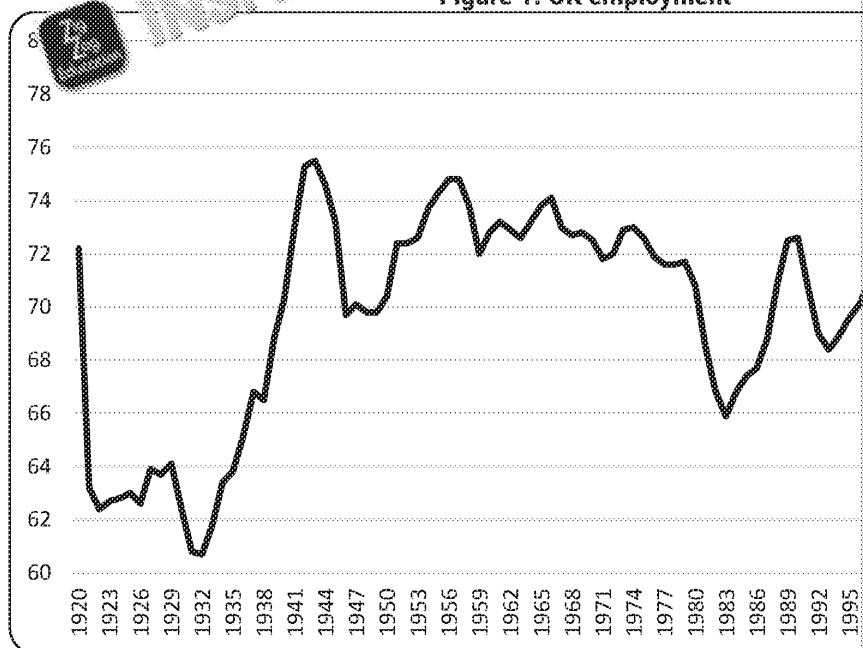
Full employment or underemployment

2.5 The economic cycle

Unemployment can be one of the most persistent and damaging economic problems. Some Eurozone countries, such as Spain and Italy, have experienced eye-watering levels of youth unemployment since the financial crisis of 2008 – leading to fears of a 'lost generation'.

The UK was also buffeted by a spike in unemployment following the crash, as shown in Figure 1, but since then a rather different story has played out. The UK's employment rate has consistently grown to the highest it has ever been – peaking at 76.5% in 2020. Even the impact of the coronavirus pandemic had only a minimal effect on the long-term high employment trend.

Figure 1: UK employment



The figures look impressive on the surface, but they don't appear to tell the full story. Record highs, poverty has been increasing, productivity stagnating and real wages falling.

One answer is that, while more people are in work than ever before, their jobs are less remunerated than in previous eras. We can see a correlation between the rise in employment and a relaxation of labour rules in the economy in order to encourage more 'flexible' work. Implementation of a more flexible labour market was intended to restore profitability as well as reduce what were then rising levels of unemployment.

Reforms to employment contracts between 2010 and 2015 included removing restrictions permitting more flexible employment contracts, reducing regulation around the hiring and firing process, making unfair dismissal more difficult, removing the compulsory retirement age, and strengthening enforcement around employment rights. In 2013, the Department for Business Innovation and Skills described the UK labour market as 'one of the most lightly regulated labour markets in the world'.

While boosting employment figures, this approach also risks creating underemployment. Many people would like to work more hours than are available to them. Flexible labour is utilised in the public and social care sectors, though present across the economy. Figure 2 demonstrates the impact of these measures, after the new flexible labour rules were introduced.

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Figure 2: UK unemployment



Underemployment may be preferable to unemployment statistically, but it can place government finances under strain, as workers on low wages or with few hours do not contribute as much to the welfare system.

Use the data

- Using Figure 1, identify the year which saw the previous highest recorded level of unemployment prior to 2020. Can you explain why this might be?
- Using Figure 2
 - Explain why the Claimant Count measure of unemployment is usually lower than the Labour Force Survey measure.
 - Explain why this is not the case in 2020 and 2021.

Test your knowledge...

- Explain why the unemployment rate could be considered misleading.
- Figure 1 shows a rise in unemployment numbers during the financial crisis of 2008. Explain the two types of unemployment that are most likely to have taken effect during this time.

Extended response question

- Evaluate the consequences of unemployment for the economy and society.

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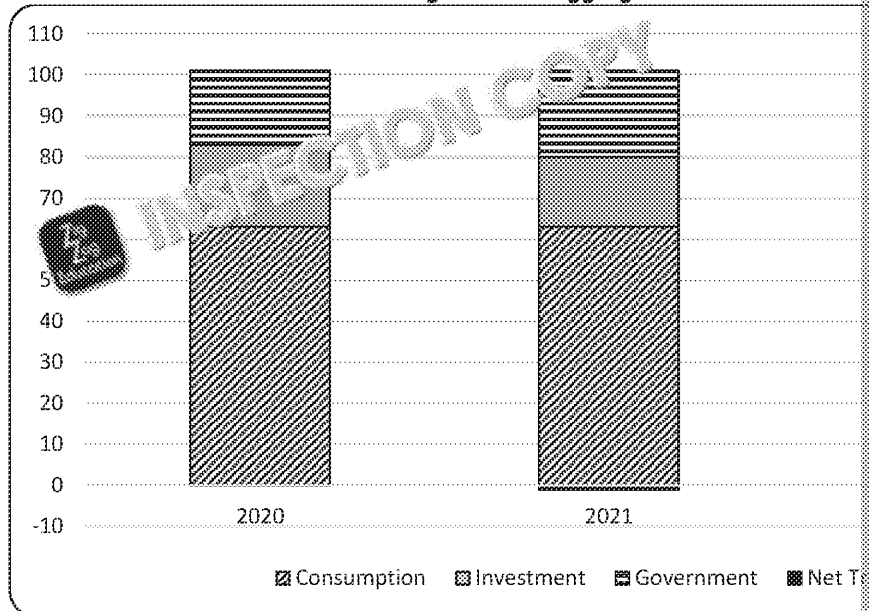


Collapsing consumption during the coronavirus

2.5 The economic cycle

The response to the spread of the coronavirus pandemic had a profound effect on the economy. With large parts of the economy closed, and consumers confined to their households, consumption fell to an unprecedented extent. This is because the largest component of aggregate demand is consumption, which shows that consumption represents 63% to 64% of the UK's total GDP.

Figure 1: UK aggregate demand



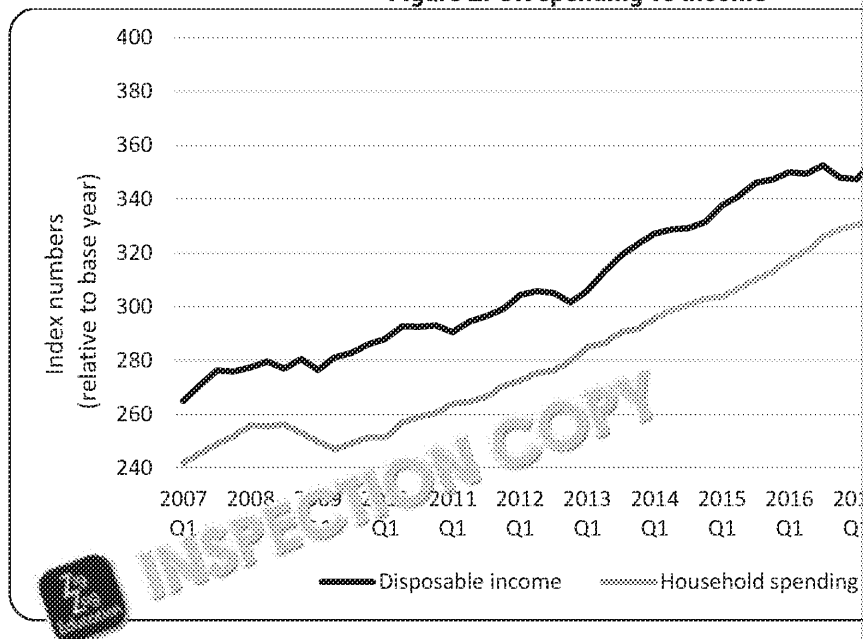
Government intervention during the crisis sought to support the economy while consumption fell. The main way the government intervened was the furlough scheme. This ensured that employed people received a proportion of their wages while they were unable to work due to social gatherings. In addition, the government also increased support for unemployed people received through the Universal Credit, also reducing barriers to access.

The effect of these interventions can be seen in the fact that household spending – or consumption – decreases dramatically. In 2020, disposable income reduces only by a relatively small amount.

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Figure 2: UK spending vs income ⁶



However, despite the collapse in consumption overall, some sectors of the economy grew. Essential retail was one beneficiary – in particular supermarkets. As these were some of the few places that remained open, and one of the few outside activities people were permitted to engage in, footfall

Another beneficiary was online retail. With people forced to stay home, a large amount of shopping that previously took place on high streets moved online. The share of sales conducted online rose to 30%, in the first months of the pandemic. However, overall sales over the same period

After the height of the pandemic, household sales rebounded, though, as Figure 2 shows, they did not reach 2020 levels, demonstrating that reduced consumer confidence remained across the

Use the data

1. Is the data in Figure 1 in real or nominal terms?
2. Take a look at Figure 2. What might account for the small reduction in disposable income in the second quarter of 2020?

Test your knowledge...

1. Explain the formula for aggregate demand.
2. Using an AD curve, explain the effect of a fall in the rate of VAT.

Extended-response question

1. Assess the relative importance of interest rates and consumer confidence in determining aggregate demand.

⁶ Source: <https://www.niesr.ac.uk/wp-content/uploads/2022/02/UK-Economic-Outlook-Winter-2022.pdf>

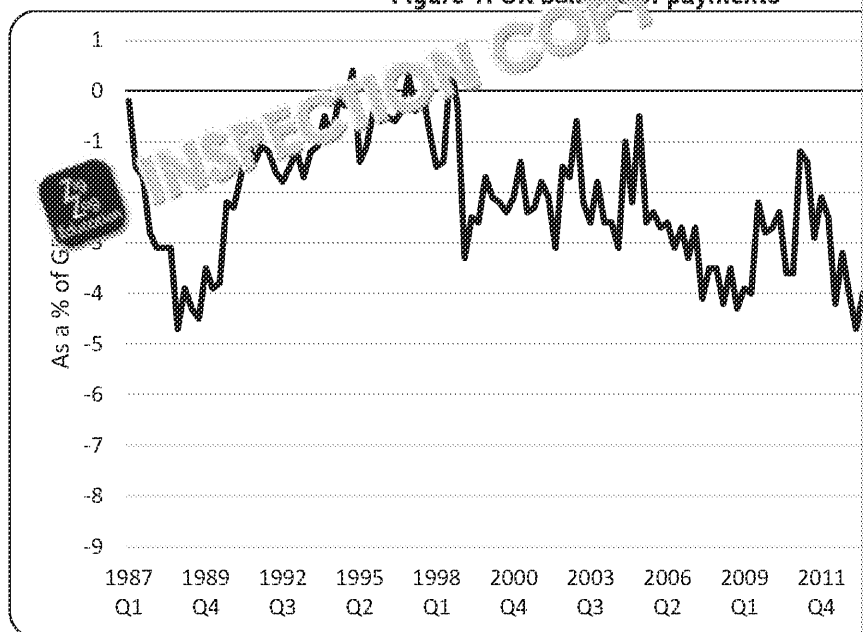
'The kindness of strangers' – running a large current account deficit

2.6 Introduction to macroeconomic policy

In early 2022 the UK posted its largest recorded current account deficit by a large margin. Statistics reported a deficit of £51.7 billion – the equivalent of 8.3% of the nation's GDP.

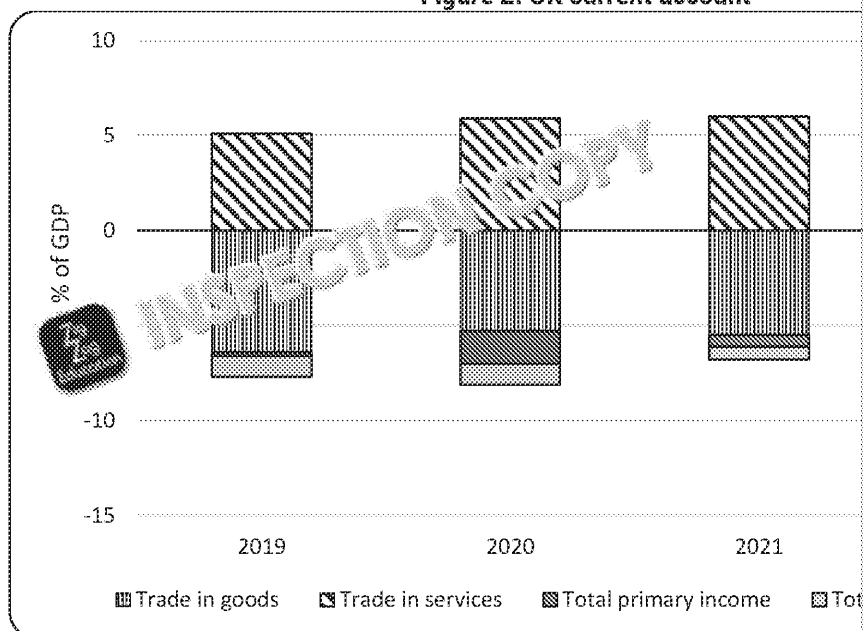
The figure sounds alarming – it is not normal for developed economies to run such large current account payments current accounts. But when we look at **Figure 1**, we see that it was only the first current account surplus for more than 20 years. So what's going on?

Figure 1: UK balance of payments



The balance of payments current account is chiefly influenced by the extent of imports and exports in the economy. However, it also counts inflows and outflows of primary and secondary income. The current account in recent years is broken down in **Figure 2**. The current account can often be volatile because of the value of the currency, which reduces demand for exports and makes imports cheaper, thus causing a deficit. The same dynamic is true of a surplus, only the other way round.

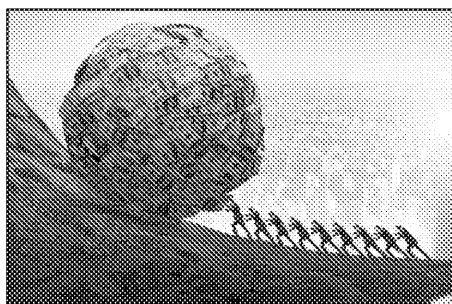
Figure 2: UK current account



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Current account deficits are not inherently 'bad' in the same way that running current accounts are not inherently 'good'. Developing countries may wish to run a current account deficit to improve their productivity in the future. Conversely, countries that rely too heavily on exports may be in trouble if the price of their commodity falls unexpectedly. In this sense, neither a deficit nor a surplus is inherently desirable or problematic.



The problem, however, can be the size of the deficit over a period of time, and governments are often required to make payments to maintain them, then this could lead to high payments which disrupt the functioning of the economy. High payments could then spook lenders and make it hard to secure low rates of interest, which in turn exacerbates the problem.

Historically, the UK has rarely had a problem with its ability to repay debts and as such has been able to maintain a long time reliance on 'the kindness of strangers' to keep it afloat. But past performance is not a guarantee of future success. Former Bank of England Governor Mark Carney in 2016 that the UK has for a long time relied on 'the kindness of strangers' to keep it afloat.

If the UK is borrowing so much that it no longer looks like a stable investment, then those 'strangers' may stop lending.

Use the data

- Using Figure 2
 - Which of the components of the current account appears to be steadily increasing?
 - Which of the components of the current account has contributed most to the overall current account deficit?
- If the UK's current account deficit in Q1 2022 was £51.7 billion, and this is equal to 0.5% of GDP, then what was the UK's overall GDP figure in Q1 2022?

Test your knowledge...

- Explain what is meant by 'total primary income' and 'total secondary income'.
- Explain the effect on the current account balance if the value of UK investments abroad increased.

Extended-response question

- Evaluate the effectiveness of investing in the UK's export sectors as a way of reducing the current account deficit.

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Expansionary fiscal policy: eat out to

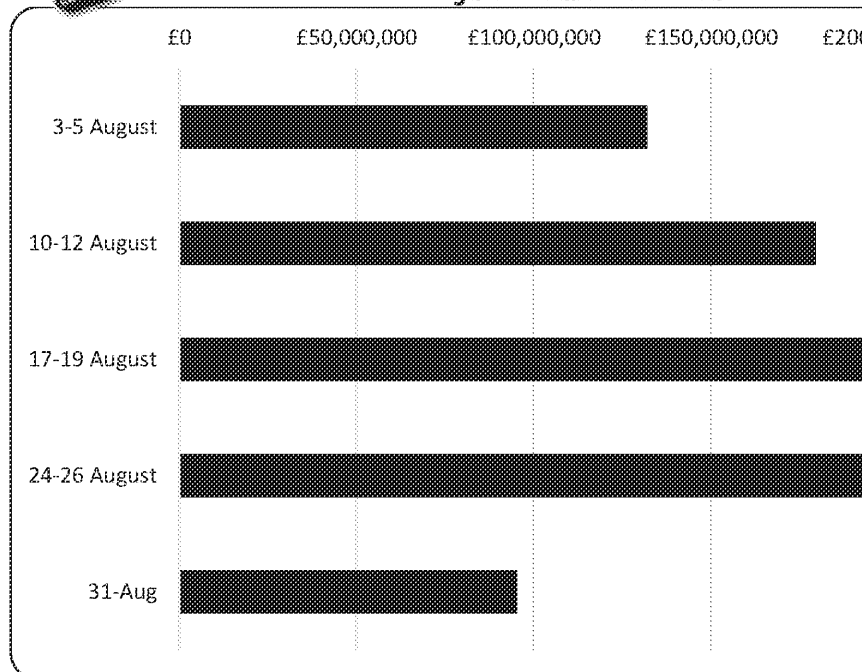
2.6 Introduction to macroeconomic policy

The hospitality industry was among the worst affected sectors of the UK economy during the coronavirus pandemic crisis. With the population forced into their homes, bars, restaurants and cafes had virtually no means to generate revenues which could cover their core maintenance costs, and many ended up in a perilous financial position.

As the spread of the virus appeared to dissipate during summer 2020, the government launched an unusual fiscal stimulus not to support the industry. The 'eat out to help out' scheme subsidised food and soft drinks in hospitality venues by 50% every Wednesday for the whole of August. **Figure 1** shows the increasing popularity of the scheme over the course of the month, based on the money spent by the government.



Figure 1: Subsidised meals



The overall cost of the scheme was £840 million, significantly greater than the £500 million initially estimated by the government. The aim of the government was to boost overall aggregate demand in the recessionary pressures as the UK left lockdown. The government was anxious that public spaces, and demand would continue to be suppressed due to the public having to save.

Research conducted by the London School of Economics, or LSE, suggests that the scheme did not boost aggregate demand as much as the costs involved. The LSE concluded that it did not boost demand in designated periods, and there was no evidence to suggest that it encouraged

However, the government argues that the scheme was effective at keeping struggling businesses afloat, preventing them from laying off staff, by providing them with much needed revenue. The scheme helped to reduce the cost of furlough, given that the hospitality industry was subsidising wages during the pandemic. **Figure 2** shows the number of employees furloughed in November 2020.

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Figure 2: Furloughed workers



In addition, some studies found that the scheme may have contributed to the increase in the virus. Increased transmission meant that restrictions on social gatherings began to be implemented in September, less than two weeks after the scheme ended.⁷

Use the data

1. What does the take-up of the scheme indicated in Figure 1 tell us about the demand for the services provided by the hospitality industry?
2. Take a look at Figure 2. Does it indicate that the 'eat out to help out' scheme encouraged employees furloughed?

Test your knowledge...

1. Explain how expansionary fiscal policy correlates to the economic cycle.
2. Explain the effect of fiscal stimulus on AD using a Keynesian AD/AS diagram.

Extended-response question

1. Evaluate the effectiveness of using demand-side policies to stimulate economic growth.

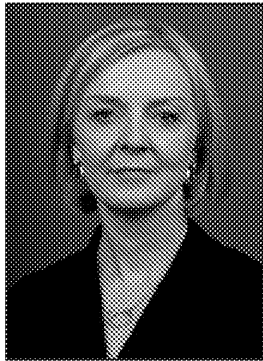
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⁷ https://cep.lse.ac.uk/textonly/_new2014/news/releases/2021_02_10_i394.pdf LSE study

Fiscal misadventure: Truss's tax ga

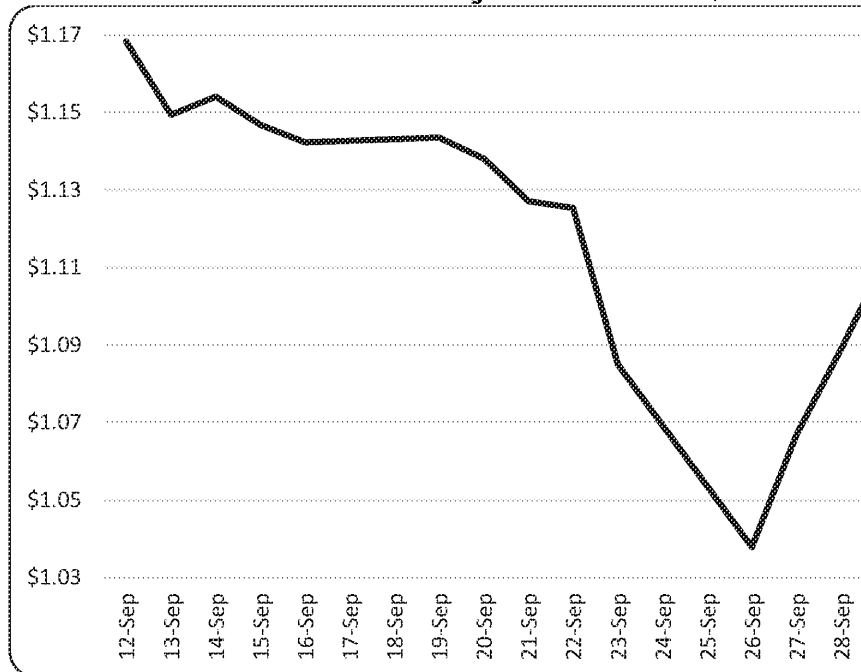
2.6 Introduction to macroeconomic policy



In September 2022, the recently elected British Prime Minister Liz Truss announced a range of large public spending cuts. A range of £100 billion was announced to cover the energy costs of the war in Ukraine, followed by a further £45 billion worth of tax cuts, intended to support a range of individuals and businesses and generate economic growth. Liz Truss, responsible for explaining how public expenditure was to be raised, permitted to issue any public information about how the money was to be raised.

The reaction of financial markets to the latter announcement was swift. Investors, spooked by the enormous unfunded spending commitments, doubted whether Britain would be able to continue paying off its debts, and lost confidence in the government's financial governance. Many started selling their UK financial commitments. This led to a sharp fall in the value of the British pound, seen in Figure 1 against the US dollar.

Figure 1: Value of £ in \$



At the same time the price of government debt – its value on financial markets – also fell. A major source of investment in government debt is pension funds, as the bond market becomes a source of pensions start to be put at risk. Eventually the Bank of England stepped in when pension funds about to collapse. The central bank spent £100 billion buying government debt, which helped to stabilize the market and also restored some of the pound's value.

But the emergency intervention by the central bank also added to the inflationary pressure on the economy. The prospect of large interest rate rises severely affected the mortgage market, with many relying on low interest rates in order to keep up with their payments. A large number of mortgages were withdrawn at the peak of the crisis.

Eventually, the political pressure that resulted from this combination of financial scandal forced the government to reverse their expensive policies, and ultimately pushed them both out of office. But an important lesson in maintaining the confidence of financial markets is to the functioning of a clear set of boundaries of plausible macroeconomic policies lie.

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Use the data

1. The pound started 2022 at a value of \$1.35. How much of its value had it lost

Test your knowledge...

1. Explain **two** functions of the financial market.
2. Explain **two** consequences of a currency depreciation.
3. Using a suitable diagram, explain how tax cuts could stimulate economic growth

Extended-response question

1. Discuss the increasing role of the central bank in managing UK financial crises

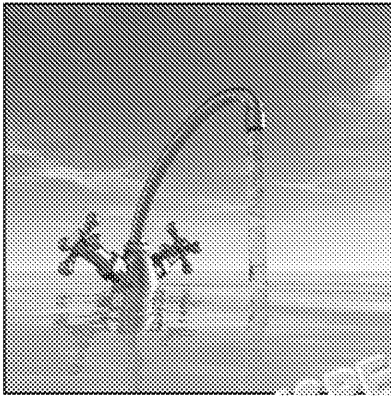
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Phillips curve: does it hold up?

2.6 Introduction to macroeconomic policy

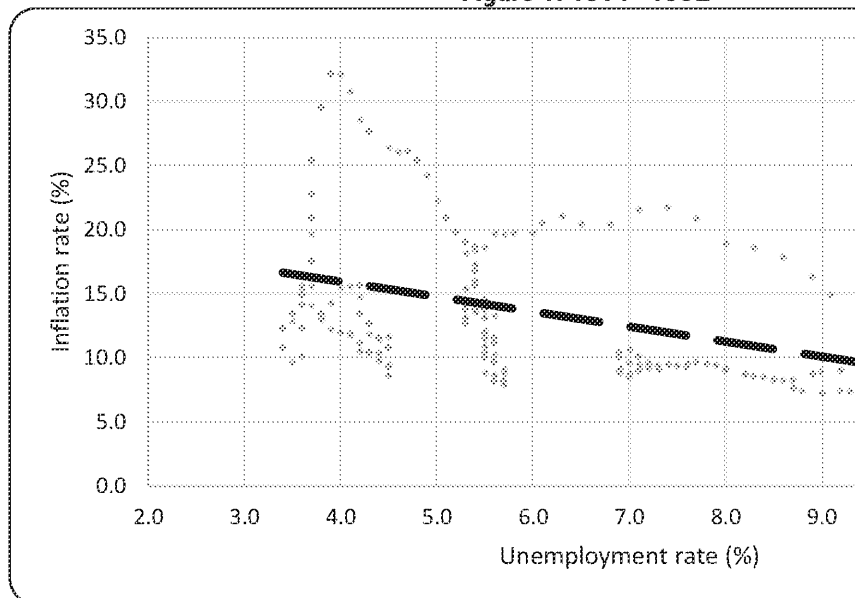


When announcing what was then the largest increase in wages in over 20 years in August 2022, the Governor of the Bank of England claimed that high levels of inflation were in part due to a 'tight labour market'. By this, Bailey means that a lack of available jobs and wages, which in turn increases prices.

This formulation is more commonly known by economists as the Phillips curve. The theoretical model of the Phillips curve demonstrates an inverse relationship between unemployment and high inflation. This relationship is a key tool for macroeconomic policymakers, because the form of the curve is an example of a government trying to control inflation without creating another in the process.

However, economic models rarely seem to perform exactly the way we expect them to. While the Phillips curve was pronounced in previous eras, it is relatively flat in the modern era. So does it actually hold? Or are there correlations where there are none? See for yourself: Figures 1 and 2 show the shape of the Phillips curve in different time periods.

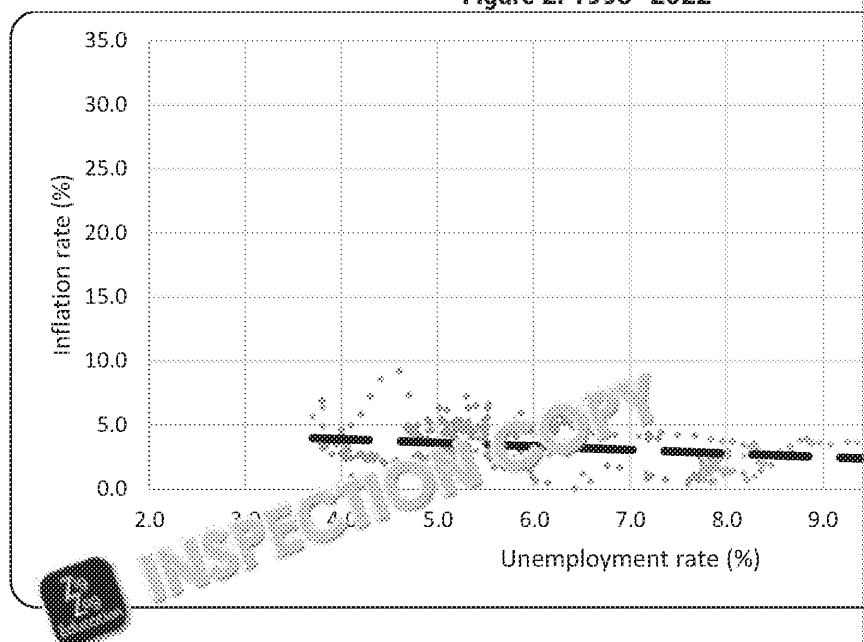
Figure 1: 1971–1992



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Figure 2: 1993–2022



As we can see, the trend in **Figure 2** is far less pronounced. As such, with inflation rising, the Phillips curve still remain a useful tool for policymakers when understanding price inflation, which could lead to counterproductive macroeconomic management?

In the case of Bailey's statement, would higher unemployment actually help to bring inflation down? at what cost? These are the types of policy conflicts, and uncertain outcomes, that economists face.

Use the data

- Using Figure 1, draw the basic Phillips curve model.
- Which of these best describes the relationship between inflation and unemployment (1993–2022): (a) positive relationship, (b) negative relationship or (c) no relationship?

Test your knowledge...

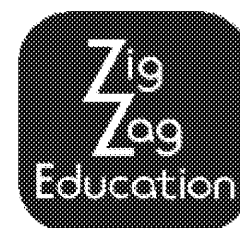
- Explain **two** reasons why high unemployment may lead to low inflation.
- Explain **two** other possible policy conflicts.

Extended-response question

- 'Governments should prioritise low unemployment over low inflation.' Assess this statement.

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Answers

Growth through acquisition: Facebook's market dominance

Use the data

1. In 2014, when acquired by Facebook, WhatsApp had 500 million monthly active users and Facebook had over 2.5 billion monthly active users. This is an increase of just under 400%.
2. Facebook's business model is based on advertising. The more active users on Facebook, the more advertisers will be willing to pay to run their ads.

Test your knowledge...

1. Horizontal integration is when two firms in the same industry (1), and offering the same product or service (1), are taken over by a single producer (1). It is the form of growth taken by Facebook in 2012, when it announced it sought to acquire Snapchat, and in 2014 when it acquired WhatsApp (1).
2. The most likely answer is sales maximisation (1).
In 2012, the social media landscape featured a number of potential competitors to Facebook (1). Google+ was a potential competitor. Based on the large acquisitions made, it would appear that Facebook's aim was to maximise its market share at this point in its development in order to prevent competition (1). 'Sales maximisation' refers to the expansion of the social media site's user base (1). We can see from the data that, in its development, such as that highlighted in Figure 2, Facebook is already so dominant that it is unlikely to be concerned with profit maximisation (1).

Extended-response question

1. A possible answer may highlight:
 - Economies of scale are the primary benefit – increasing output helps to bring about greater efficiency in the production process and leads to higher profits. Success in advertising can lead to greater credibility among lenders, which can help when trying to access credit to expand the business model, which gives a firm greater resilience when encountering market downturns. Another answer might be that growth can give a firm more market control.
 - The main cost is the level of risk that is taken on when expanding a business. If the business grows too quickly, the entire business is likely to become vulnerable. Growing too quickly can lead to the business being burdened with excessive debts. Diseconomies of scale can also emerge if the business becomes less efficient and costs increase. It might also become hard to retain its competitive advantage once it is growing at pace.

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Preview of Answers Ends Here

This is a limited inspection copy. Sample of answers ends here to stop students looking up answers to their assessments. See contents page for details of the rest of the resource.