Zig Zag Education

Economics AS/A Level | Edexcel A | 8EC0 | 9EC0

Data Response Case Studies

For AS/A level Edexcel Economics A Theme 2: The UK economy – performance and policies

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Contents

Teacher's Introduction

This resource is designed to be used for teaching Edexcel AS/A Level Economics T
performance and policies. The resource consists of 12 Data Response Case Stud
complete as homework tasks.

The case studies are presented in specification order, collectively covering each t
specification. Each case study contains detailed information (including diagrams
questions.

The 'Use the data' tasks focus particularly on quantitative skills, and the 'Test yo
knowledge and application skills. The extended-response questions are an oppo
higher-level analysis and evaluation skills. Most of the questions given are in exa
limited questions to this style except in the case of the extended-response quest
provided for all tasks and questions.

Reading through each study and answering the questions is expected to take 20-
extended-response questions at the end of each case study. One option for usin
study in class and set the exam-style evaluation question as homework.

This resource will help prepare students for the Paper 2 component of the AS/A
interest in the real-world applications of macroeconomics. Each case study uses
student to a fascinating array of contemporary and historical issues relating to th

I hope this resource helps you to bring economics to life for your students.

Case Study	Spec r
1. Economic growth in the UK – back to business as usual?	2.1 Measures of economics perfo
2. UK inflation in the 1970s	2.1 Measures of economics perfo
3. UK unemployment – successes and challenges	2.1 Measures of economics perfo unemployment)
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7. Investigating the multiplier effect	2.4 National Income (the multipl
8. Patterns in the business cycle	2.5 Economic growth (trade/busi
9. Monetary and fiscal policy in the Great Depression	2.6 Macroeconomic objectives a
10. Supply-side policies – privatisation in the UK	2.6 Macroeconomic objectives a
11. Policy conflicts – inflation and unemployment	2.6 Macroeconomic objectives a
12. When will the UK raise interest rates?	Multiple topics

Economic growth in the UK – back to bus

This case study requires knowledge of Section 2.1.1 – econc

The financial crisis of 2008 saw the UK experience the worst recession since the Great Depression. The recession saw rising unemployment, a dramatic fall in bank lending (credit), and unprecedented stimulus measures from the UK government and Bank of England to try to steer the economy back towards positive growth.

Now that the worst of the crisis seems to be over, many commentators and external organisations (such as the IMF) are optimistic about the future of the UK economy – not least since economic growth in 2014 topped that of all the other 'G7' countries (see Figure 2).

Figure 1: UK real growth rate

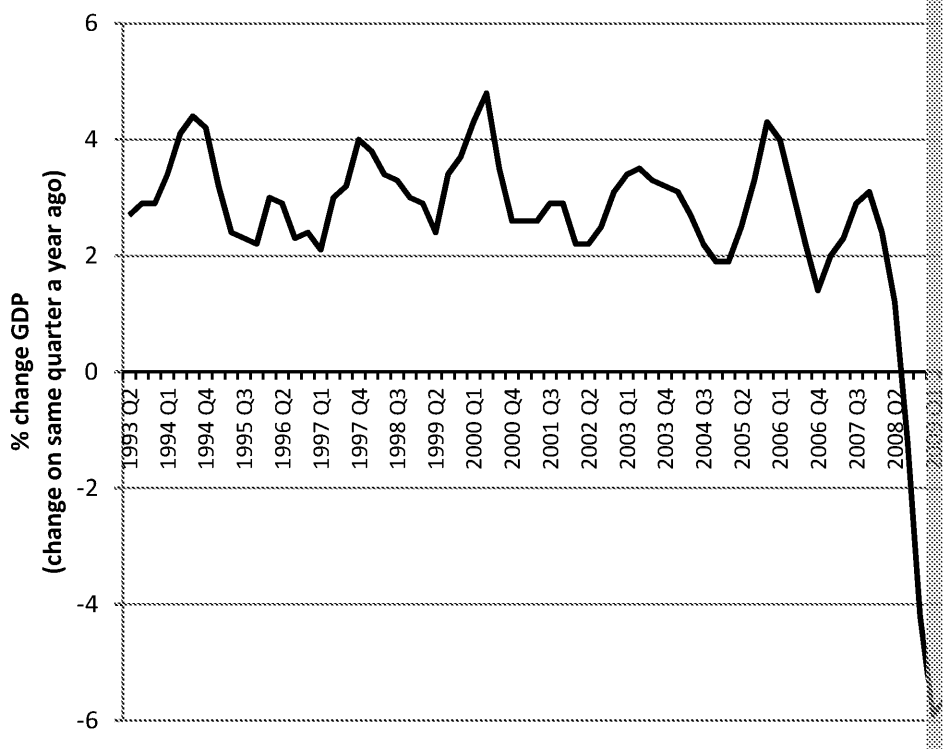


Figure 2

G7 Country	UK	Canada	USA	Germany	Fra
2014 annual real GDP growth rate	2.9	2.4	2.4	1.6	0

Many other economic indicators also seem to be showing signs of health – budget deficit is slowly narrowing (although not as quickly as the Chance wages are rising for the first time in several years (particularly notable sin Some attribute this to sensible economics on the Chancellor's part – strong responsibility seem to have boosted market confidence (the costs of borro

have remained low – unlike imperilled economies such as Greece). Other
government spending more gradually would have led to more reliable gr
more to do with the revival of the world economy than any policy of the C
oil has also been an unexpected bonus for the UK as a net importer of oil.

In the 2015 Autumn Statement, the Chancellor announced relatively expa
designed to boost economic growth, rather than lower the national debt) a
economic growth predictions by the Office for Budget Responsibility (OBR
included postponing cuts to tax credits, and increasing the police budget a

Critics argue that predicting economic growth rates is notoriously difficul
on forecasts is a risky move. There are some clear threats to the UK and th
including a slowdown of economic growth in China, and a chronic shorta
market. Hopefully the forecasters are right to predict that the UK will retu
can't know for sure.

Use the data

1. Estimate the average annual rate of GDP growth in the UK from 1993 to 200
2. Briefly describe how Figure 1 would change if nominal GDP figures were use
3. Suppose the USA's real GDP at the start of 2014 was $17 trillion. What wou
   the figures in the extract?

Test your knowledge…

1. Define real GDP.
2. Give two reasons from the passage why the UK's growth rate was relatively

Extended-response question

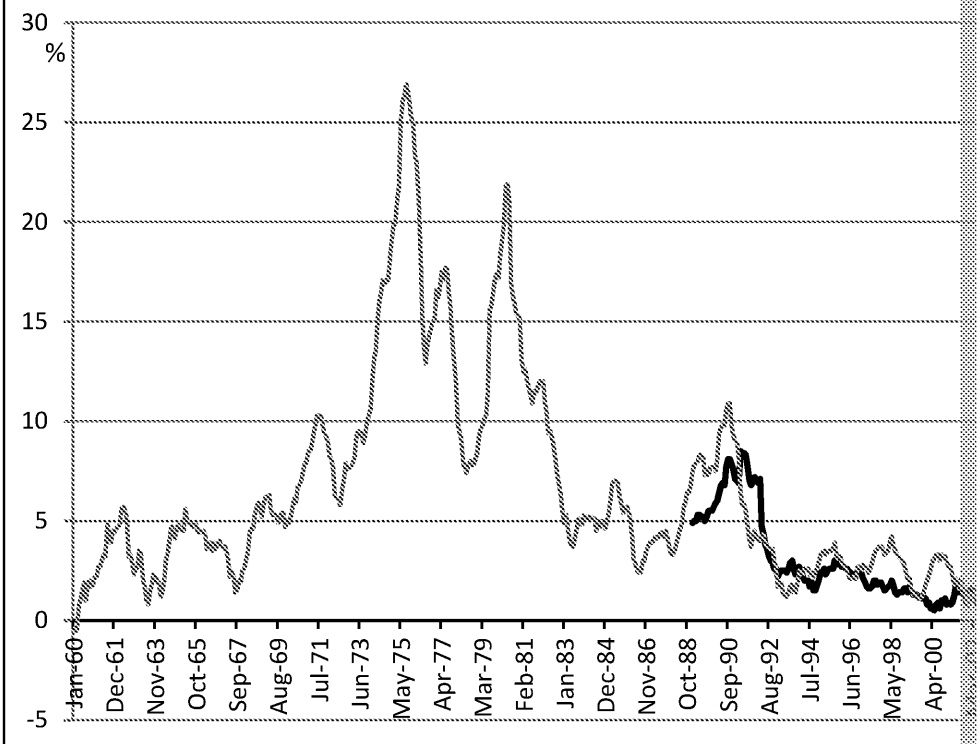
1. 'Once population size and inflation are accounted for, GDP is a good measu
   economy is.' Evaluate this claim.

UK inflation in the 1970s

This case study requires knowledge of Section 2.1.2 – in

Inflation figures in the UK tend to be buried in the financial sections of ne has been very modest over the past few decades (hovering close to the Ba although the near-zero rate in 2015 piqued some interest. However, in the the 1980s) inflation was a serious concern.

Figure 1: UK inflation 1960–2013



Inflation data is calculated each month as the percentage change in prices from the same month

High inflation is often associated with high economic growth – inflation a 'overheating'. In the 1970s, however, economists in the UK and US were f of high inflation and low economic growth. This came to be known as 'sta

One of the causes of this was a succession of oil price 'shocks' in the world economy – i.e. unexpected increases in the price of oil. This caused a slowdown in the UK manufacturing industry (as oil is a key cost of production) as well as an outflow of money from the UK to foreign oil producers (since the use of cars had become highly popular). These are examples of cost-push and demand-pull inflation, respectively.

It has also been observed that the government's policy response worsened were kept too low. Low interest rates lead to inflation if economic activity possible level. Unfortunately, the government had inaccurate data on the thought it had a greater capacity to grow than it actually did (they overest *gap*). In retrospect, it would have made more sense to increase interest rat

Following this episode, policymakers tended to become more 'hawkish' – emphasis on controlling inflation, possibly at the expense of economic gro entered a period of relatively stable inflation in the UK, policymakers have concerned with promoting economic growth than worrying about high in

Use the data

1. Using Figure 1, what was the highest inflation rate experienced by the UK in
2. (a) In percentage points, what was the approximate change in the rate of i July 1982?
   (b) What term describes this kind of change?
3. Describe the trend in the inflation rate during the 1970s.

Test your knowledge...

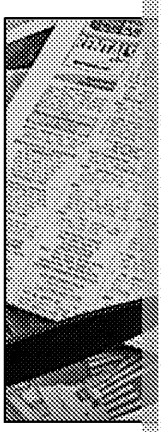
1. State one reason why inflation increased in the 1970s.
2. Explain the difference between deflation and disinflation.

Extended-response question

1. Discuss the costs of inflation for an economy.

UK unemployment – successes and

This case study requires knowledge of Section 2.1.3 – employment



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 Figures 1 and 2 show, but since 2013 the situation seems to have improved dramatically.

Figure 1: Measures of total unemployment (age 16+)

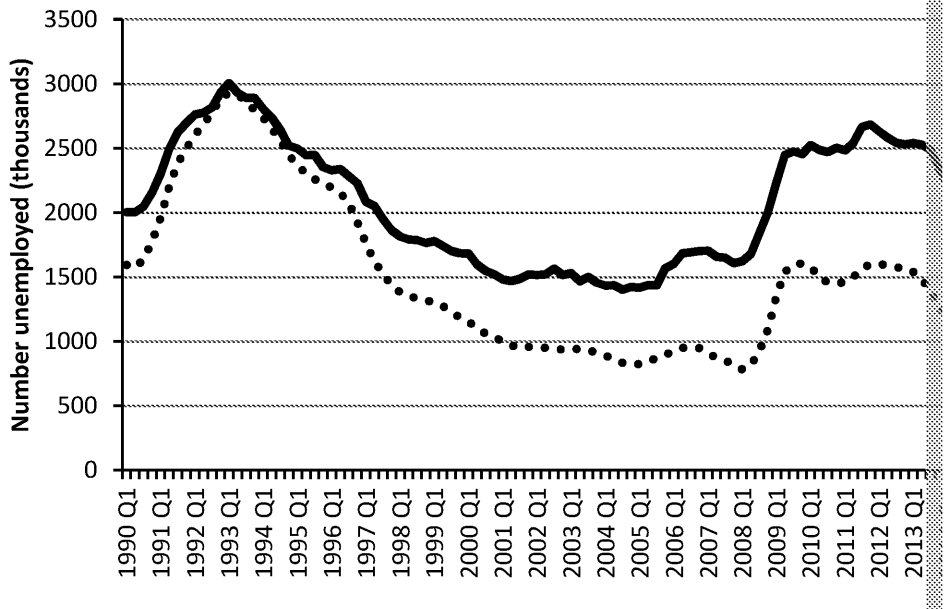
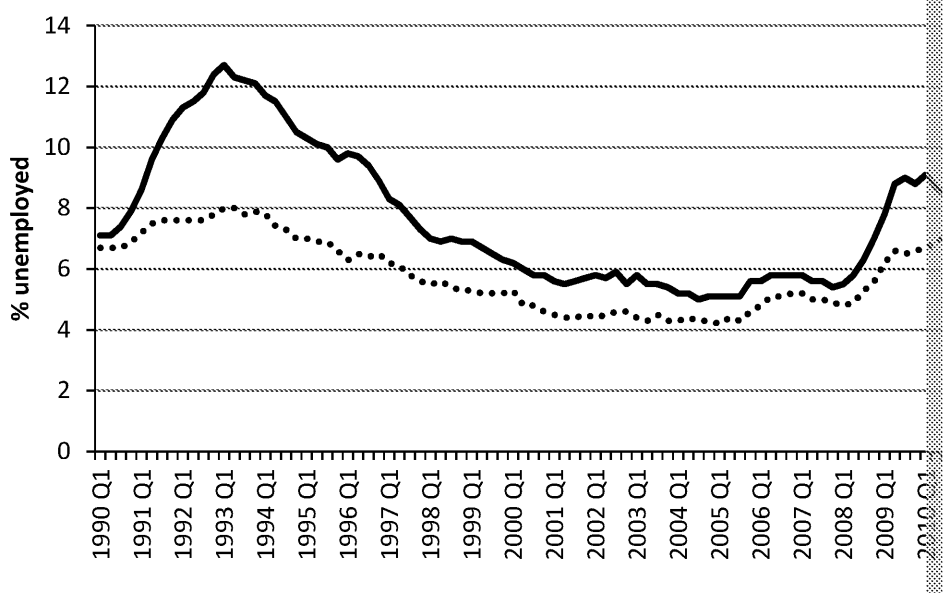


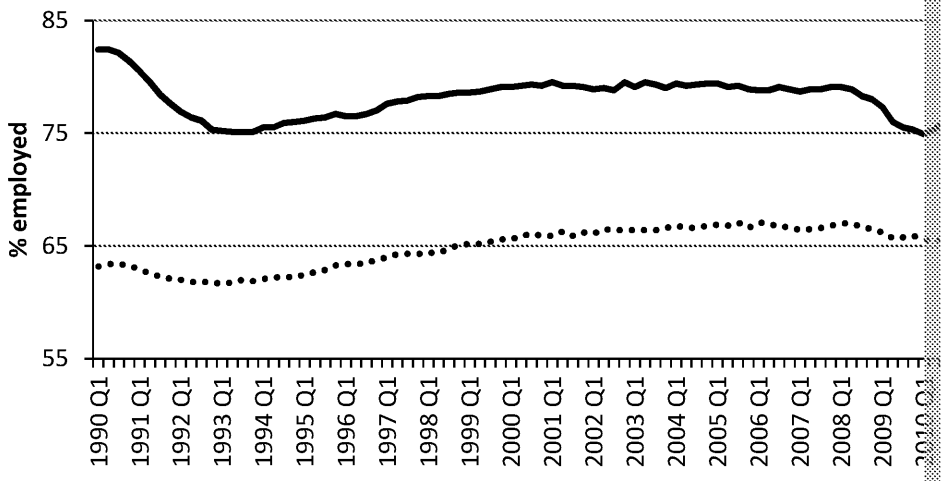
Figure 2: Unemployment rates (male/female)



The UK is not out of the water just yet, however. There have been heavy j
industry, as competition from abroad proved too fierce to make the indus
could try to prop up the industry via increased subsidies, but unless the u
issues are tackled, it is feared that this would amount to signing a 'blank c

There have also been concerns that the unemployment figures only appea
emergence of 'zero-hours contracts' – but hard evidence on this is difficult

Figure 3: Employment rates (male/female)



Another perplexing pattern has been observed since the crisis: even thoug
risen and unemployment figures have fallen, wage growth has been stagn
wages to rise when unemployment is low).

One reason might be that inflation has been very low – if inflation were hi
demanding nominal wage increases. Another is that more people are hav
time, as their employers cannot afford to have them work longer. A more
sluggish wage growth is that the proliferation of cheap capital goods has r
(e.g. the introduction of self-service machines at McDonald's). Whether th
remains to be seen.

Use the data

1. Looking at Figure 1, explain why the Claimant Count measure of unemploym
Labour Force Survey measure.
2. Suppose that in 2000 Q1 (quarter 1) the population of the UK was 60 million
consisted of 55% of the total population, use Figure 2 to estimate the numb
economy.
3. Look at Figure 3. What can you observe about the difference between male
Can you think of any reasons behind the differences shown in the graph?

Test your knowledge...

1. Define the term 'economically active'.
2. Figure 1 shows a rise in unemployment numbers during the financial crisis c
unemployment that is likely to have taken effect during this time.

Extended-response question

1. Discuss the consequences of unemployment for the economy and society.

Should we be worried about the UK's curre

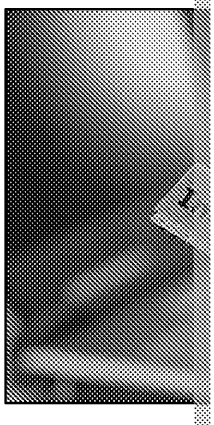
This case study requires knowledge of Section 2.1.4 – balance
You should be familiar with the current account component of the balance of pa
to have some understanding of how exchange rates

In the UK there has been much talk about the budget deficit – but less abo
The budget deficit (which was £142 billion in 2010) seems to be falling stea
billion in 2014). However, the story is quite different for the current accou
period it jumped from £41 billion to around £92 billion.

Figure 1: UK Current Account Balances as a percentage of GDP

Quarter	Total	Trade	Primary
Q3 2012	-3.1	-1.7	-0.
Q4 2012	-4.2	-2.5	-0.
Q1 2013	-4.2	-1.7	-0.
Q2 2013	-3.2	-1.6	0.
Q3 2013	-4.6	-1.6	-1.
Q4 2013	-6	-2.9	-1.
Q1 2014	-4.5	-2.2	-1
Q2 2014	-4.2	-1.3	-1.
Q3 2014	-5.4	-2	-2
Q4 2014	-6.3	-2.1	-2.
Q1 2015	-5.2	-2.3	-1.
Q2 2015	-3.6	-0.7	-1.

The last columns of Figure 1 show the three components of the current acc
minus imports), net investment income (or 'primary income') and net inte
'secondary income'). The sum of these gives the total current account bala



Current account deficits are not inherently 'bad' in the same way that running current account surpluses is not inherently 'good'. Developing countries may wish to run a current account deficit to import capital goods, with a view to improving their productivity in the future. Countries that rely too heavily on their exports may run into trouble if the price of their commodity falls unexpectedly (as with oil-producing countries in 2015/16).

Running a current account deficit is nothing new for the UK: there hasn't b
But some economists are concerned about the size of the deficit: the figure
Q4 2014 is the largest ever deficit in peacetime.

One of the worries about current account deficits is that they have to be fu
borrowing. If this persists over time, interest payments become a burden
also be funded by foreign investment in the domestic country. A recent ex
investment in building nuclear power stations in the UK. Some fear that t
foreign countries could compromise an economy's long-run growth poten

Others argue that if the deficit grows too large, the exchange rate will dep
balance to improve. They also argue that investors have a lot of confidenc
many other measures it is performing strongly. Therefore, investors will r
time soon. Furthermore, now that the UK is a net importer of oil, the low
deficit from worsening (so long as prices stay low).

It remains to be seen whether the UK government or the Bank of England
reduce the current account deficit, or whether market forces could solve th

Use the data

1. Look at the data in Figure 1.
   (a) Which of the three components of the current account appears to be s
   (b) Which of the three components seems to have worsened over time (i.e
2. (a) Suppose UK GDP in 2012 was £1,600 billion (or £1.6 trillion). Using the
   size of the current account deficit in Q3 (quarter 3) 2012.
   (b) If UK GDP in 2014 was £1,750 billion (or £1.75 trillion), calculate the siz
   Q3 (quarter 3) 2014.

Test your knowledge...

1. Based on the article:
   (a) Explain the effect on the current account balance if the value of UK inv
   (b) Explain the effect on the UK's current account balance of an increase in

Extended-response question

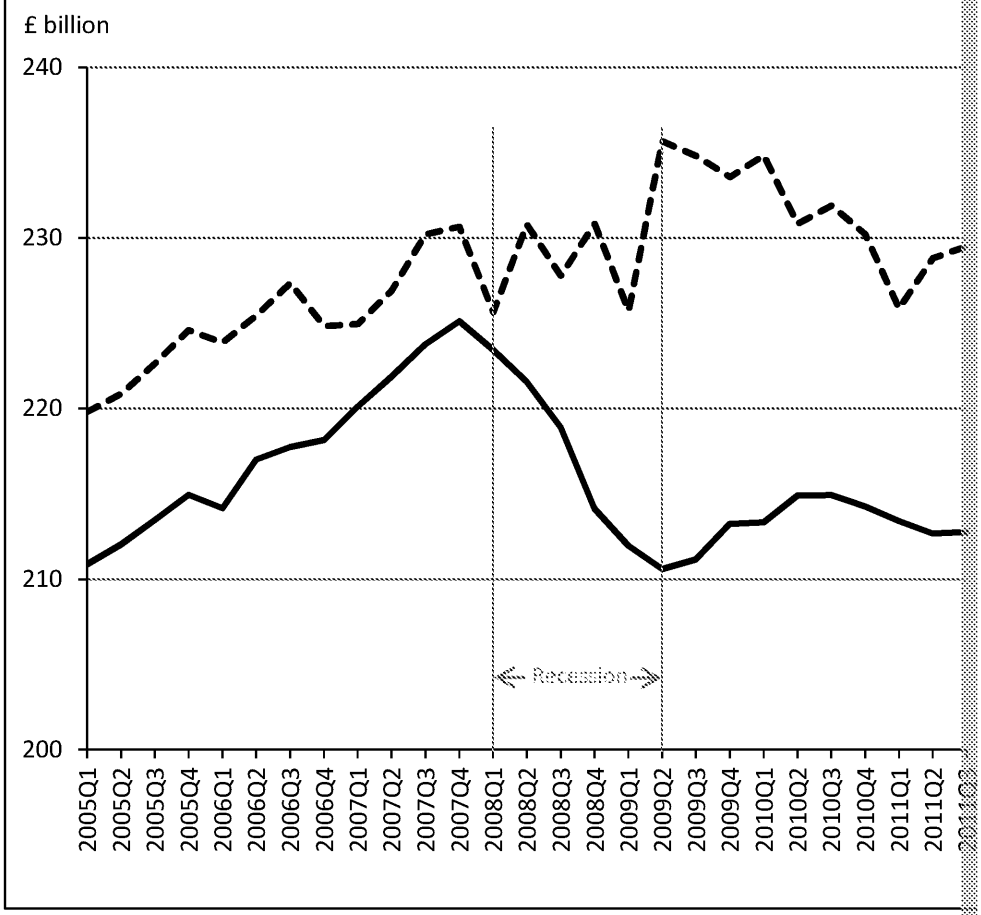
1. Assess the effectiveness of investing in one of the UK's export sectors as a w
   account deficit.

The UK's slump in consumption during

This case study requires knowledge of Section 2.2 – Aggregate Demand. Yo components of aggregate demand and the influences on these components

The 2008 global financial crisis had a pronounced effect on aggregate dem largest component of aggregate demand is consumption – accounting for Figure 1 shows how household spending (which is equivalent to consump recession:

Figure 1: Volume of Household Spending and Disposable Income



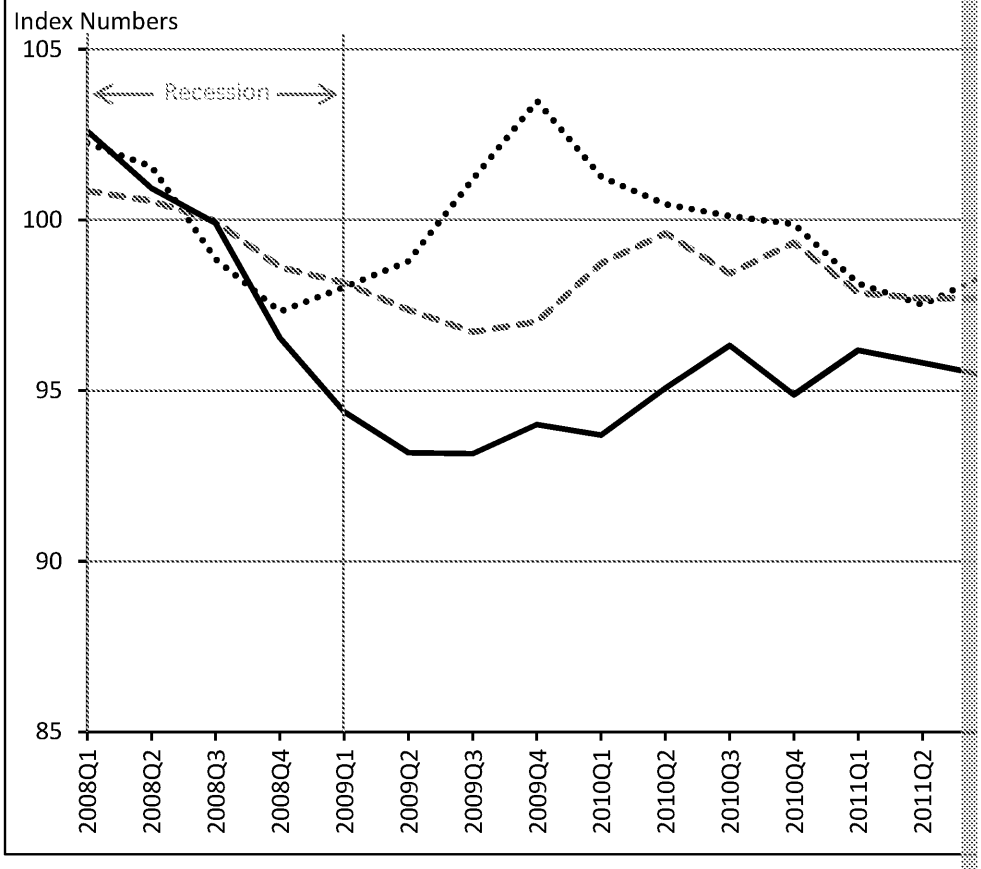
The Labour government at the time attempted to reverse the trend using many tools, such as adjusting taxes (e.g. lowering VAT and increasing the income tax threshold), bailing out the financial sector, and relying on the Bank of England to lower interest rates (interest rates fell steadily from 5.75% in 2007 Q3 down to 0.5% by 2009 Q2.

It is interesting to compare the trend in disposable income with the trend in household spending. Even though disposable income remained fairly constant (even increasing in 2009), household spending fell sharply. This is despite the fact that disposable income is usually believed to be the main factor affecting consumption.

The main explanation for this is that household saving increased in the sa households chose to pay off their debts that they had accumulated during mid 2000s. In economic terms, paying down debts is classed as saving.

Figure 2 shows how consumer spending on different types of goods was a

Figure 2: Volume of Goods and Services purchased 2008–2011 (2008 =



Non-discretionary goods and services are essential products, such as stapl
Discretionary goods and services are desirable, but not necessary. Examp
leisure activities.

Since 2011, consumption seems to have grown slowly but steadily as the g
finances improved.

Use the data

1. Is the data in Figure 1 in real or nominal terms?
2. Looking at Figure 2, estimate (in percentage terms) how much discretionary
(quarter 3) and 2009 Q3.
3. In 2009 Q1 (quarter 1), was spending on discretionary goods and services hi
non-discretionary goods and services?

Test your knowledge...

1. What is the formula for aggregate demand?
2. By approximately how much did household spending fall between its highes
Figure 1?
3. Using an AD curve, show the effect of a fall in the rate of VAT.

Extended-response question

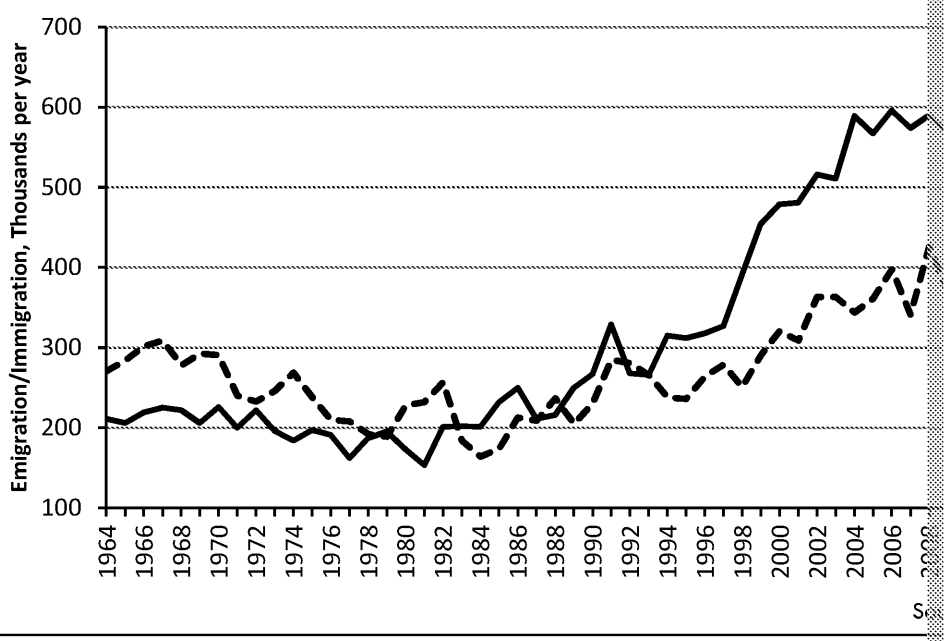
1. Discuss the relative importance of interest rates and consumer confidence i
demand.

The economics of immigrati

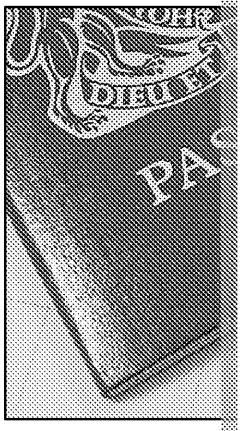
This case study requires knowledge of Section 2.3 – aggreg

The humanitarian crisis in Syria has revived old debates about the effects ‘host’ nations. There are a plethora of arguments related to the *social* cons information on the *economic* effects of migration is relatively scarce.

Figure 1: UK Emigration/Immigration figures – 1964–2014



There are several different areas of the economy that migration studies ma areas is the effect of migration on the wages and employment rates of nati belonging to the host nation). The concern is that the influx of labour dep employment (using a simple demand and supply diagram, immigration is supply of labour).



Others counter that this argument falls foul of the ‘lump of labour’ fallacy: the fallacy that there are only a fixed number of jobs to go around in the economy. Since migrants also contribute to greater demand for goods and services, the negative effect on employment and wages may be only temporary.

Evidence on this is mixed. In the US, some studies have found evidence of small, negative effects on native wages, but European studies have tended to produce ‘statistically i that the estimates of the effects of migration on EU wages are probably clo hand, there is some evidence from European studies that immigration inst levels of natives (people drop out of the labour force due to the greater co

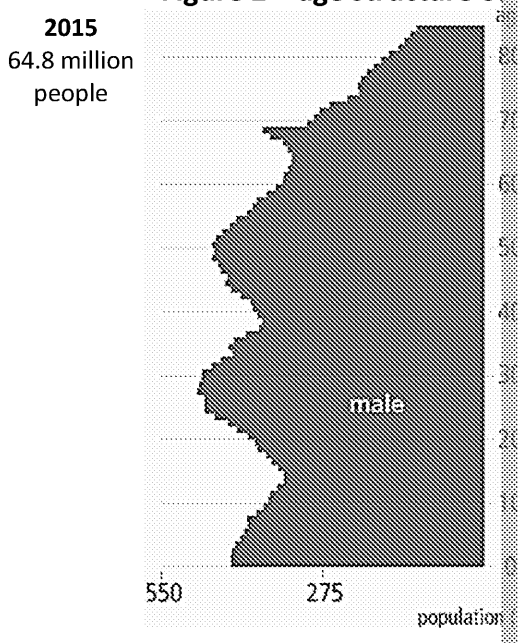
The differences in results may be because labour protection laws in Europ quite inflexible (or ‘sticky’), but the labour market in the US is more *laissez* observation is that the effect on natives depends on whether the migrants Unsurprisingly, skilled migrants seem to benefit host nations more.

One of the benefits supporters of migration point to is that it boosts the siz
population – since migrants tend to be young people looking for work. Th
increase the size of the labour force as a proportion of the total population
the UK's 'population pyramid' in 2015. The bulges show the effect of 'bab

One of the counterarguments to this is that migration simply delays the 'demographic time bomb' facing developed countries – there will still be the problem of an ageing population in the future even after migration levels tail off.

The economic arguments around migration are highly complex and often country-specific – as a discipline economics is a long way off from resolving all the nuances.

Figure 2 – age structure of



Source: *http://www.ons.gov.uk/ons/interactive/*
Visit this website to explore the changin

Use the data

'Net migration' is the difference between immigration and emigration – an annu
100,000 indicates that 100,000 more people immigrated into a country than emigr

1. When did immigration figures begin to consistently overtake emigration figu
2. Estimate net migration into the UK in the years (using a ruler might be helpf
   (a) 2006
   (b) 1979

The working age population consists of those people aged 16–64. Looking at Fig

3. Suppose one million migrants aged 20–29 came to the UK and gained emplo
   effect on the labour force participation rate?
4. Now suppose that the birth rate and death rate remains constant, and no m
   would the labour force participation rate be like after 50 years?

Test your knowledge...

'Net migration' is the difference between immigration and emigration – an annu
100,000 indicates that 100,000 more people immigrated into a country than emig

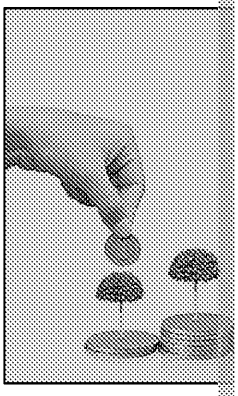
1. Estimate net migration into the UK in 2010.
2. Briefly describe the trend in net migration from 1964–2014.
3. State and explain two other factors that can increase LRAS, aside from dem

Extended-response question

1. Using information from the extract and your own knowledge, evaluate the e
   encouraging higher levels of migrant workers.

Investigating the multiplier ef

This case study requires knowledge of Section 2.4.4 – the multiplier. You sho
withdrawals and injections from the circular flow of income. It may be helpful to r

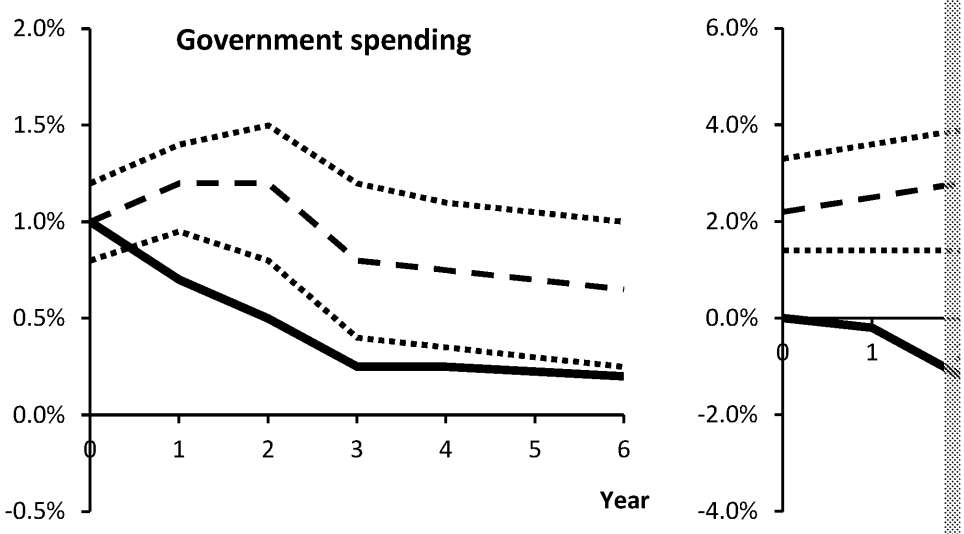


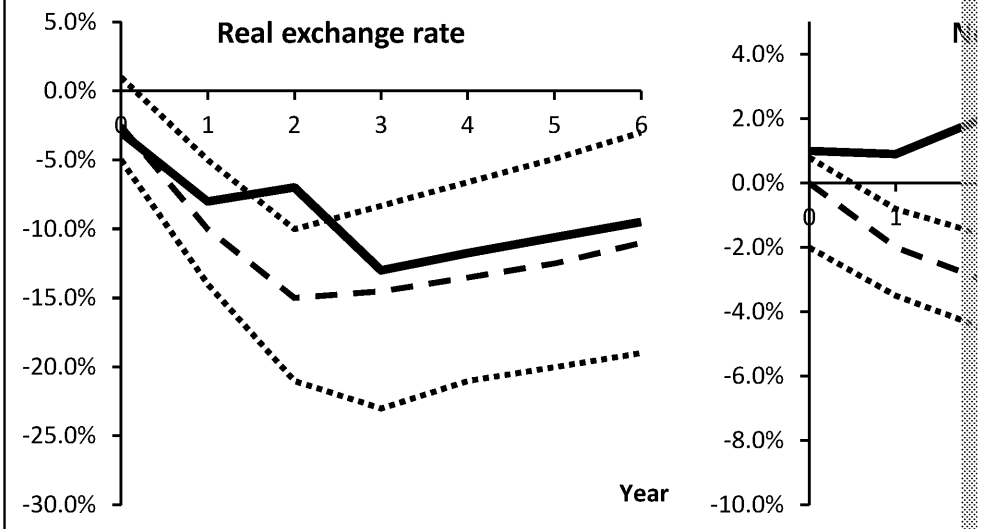
The idea of the multiplier effect in economics is quite simple in theory. When there is an injection of money into the economy (such as through government spending, or through spending by foreign tourists), the overall effect on the economy can be greater than the size of the initial injection. This is because when one person's income increases, they then spend that money, which increases the income of others, and so on, until the money is withdrawn.

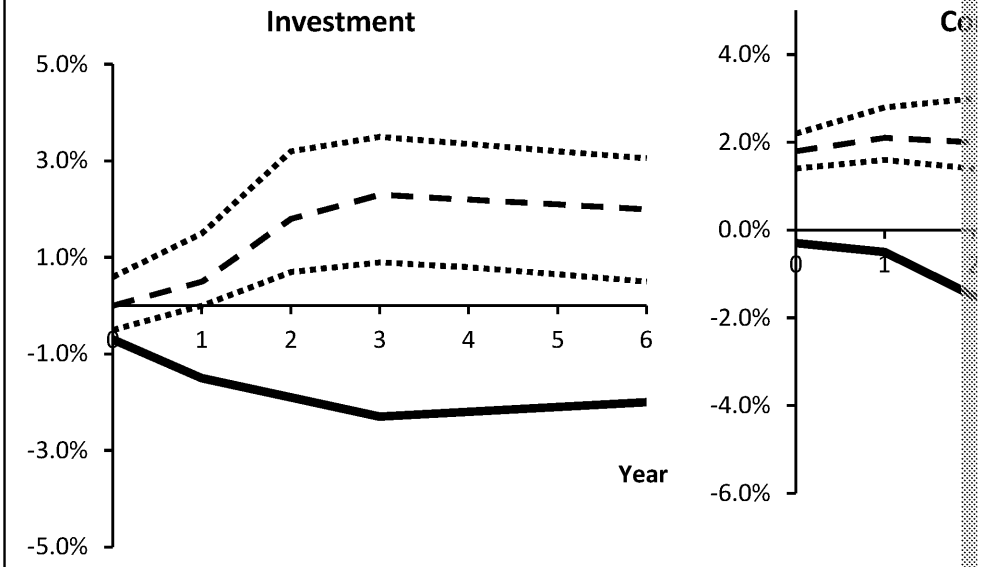
Since the financial crisis, there has been a renewed interest in estimating th whether large fiscal expansions could be a good solution to the crisis. In p the size of the multiplier has proven to be very difficult. Many studies ov quantify the size of the multiplier – but they often produce very different r research suggests that the size of the multiplier depends crucially on whet recession or not.

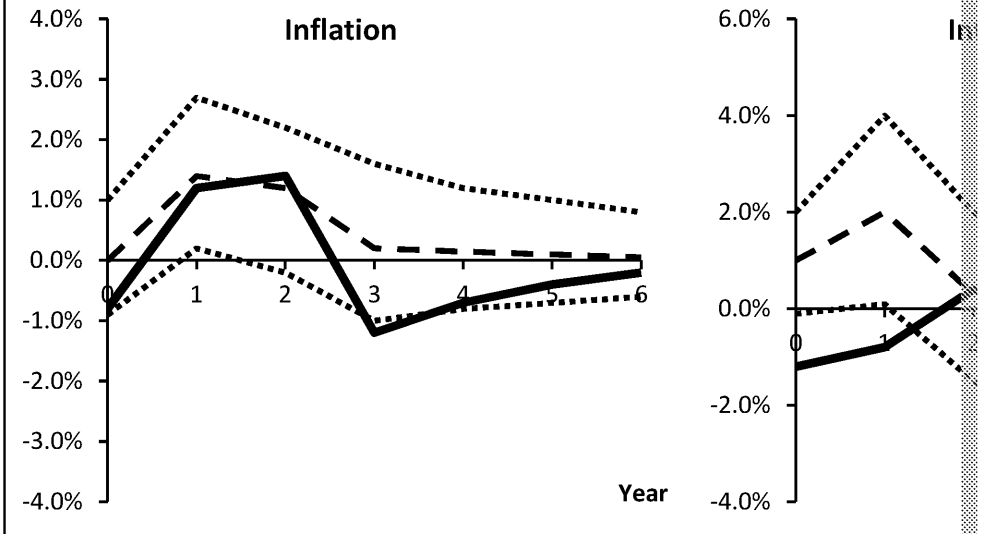
The following graphs, from IMF research, show the effect of a 1% increase several key macroeconomic variables over time. The bold line represents accounting for the state of the economy. The middle dashed line shows th variables when the economy is in recession. The other two dotted curves bound' estimates of the effect in a recession, so we can be confident that th somewhere between these lines.

Figure 1: the multiplier effect: change in variable after a 1% increase in









Source: 'What Determines Government Spending

Data is based on 17 OECD countries from 1975–2008.

So, for example, the output (or GDP) graph indicates that when the econo increase in government spending will increase output by around 2%. Thu the baseline case, the multiplier is estimated to be 0: this means that gover whatsoever on output!

The results seem to confirm that governments should seek to inject money recession. Part of the problem in the recent recession was that banks were (shortage of 'liquidity') – so more government spending could help to alle counterargument to this is that it increases the amount that the governme unsustainable. This suggests that it would a good idea for governments t economic booms, so they can afford to spend more during recessions.

Use the data

1. Look at Figure 1. Suppose government spending increased by £1.5 billion. V predicted change in consumption after two years, under the following?
   (a) The standard recession scenario
   (b) The higher estimate of the recession scenario
   (c) The lower estimate of the recession scenario
   (d) The baseline case
2. Can you think of one reason why the real exchange rate falls (depreciates) a spending? (Hint: look at the effect on inflation.)
3. Can you explain why, in the baseline case, investment is expected to fall?

Test your knowledge...

1. Use a diagram to explain why an increase in government spending is expect
2. Look at the graph showing the change in output. Compare the trend for the the recession case.

Extended-response question

1. Suppose a government wanted to help the economy out of recession by rais government spending. Using your knowledge of injections, withdrawals and effectiveness of this policy.

Patterns in the business cyc

This case study requires knowledge of Section 2.5 – Economic Growth, par

Virtually all modern economies experience fluctuations in GDP growth around trend growth, known as business cycles (or trade/economic cycles). This is where the economy follows a pattern of boom, downturn, boom, downturn, and so on. Numerous possible explanations for this phenomenon have been posited, including:

- Bubbles in markets (e.g. housing markets)
- The multiplier effect
- The accelerator effect (this is the idea that changes in national income result in greater than proportional changes in investment)
- External shocks from innovation
- Economic policies by governments
- Stock/inventory cycle – companies accumulate stocks of goods during booms, then scale back their production, amplifying the business cycle

Economists still disagree about the exact causes of business cycles, and ho them (or, indeed, whether they should try to affect them at all or just let th Brown, as Labour chancellor, famously promised to tackle 'boom and bus unable to prevent the recession following the 2008 financial crisis.

It is worth noting that slumps in the business cycle (or downturns) usually in GDP growth, rather than actual negative growth (recession – two conse GDP growth). As Figure's 1 and 2 show, negative GDP growth is relative show that the actual pattern of business cycles is quite variable: they aren' are sometimes presented to be in textbooks!

Some economists argue that the effect of 'automatic stabilisers' is sufficien In booms, tax revenues go up and welfare spending falls, dampening ecor occurs during slumps, prompting the government to fund expenditure by occur automatically, without additional government interference.

Other economists argue that automatic stabilisers are insufficient, particul recession. Expansionary fiscal and monetary policy is needed in these situ are sometimes referred to as 'Keynesian', as John Maynard Keynes advoca certain cases to help return an economy to full employment.

Figure 1: UK's annual growth rates of GDP

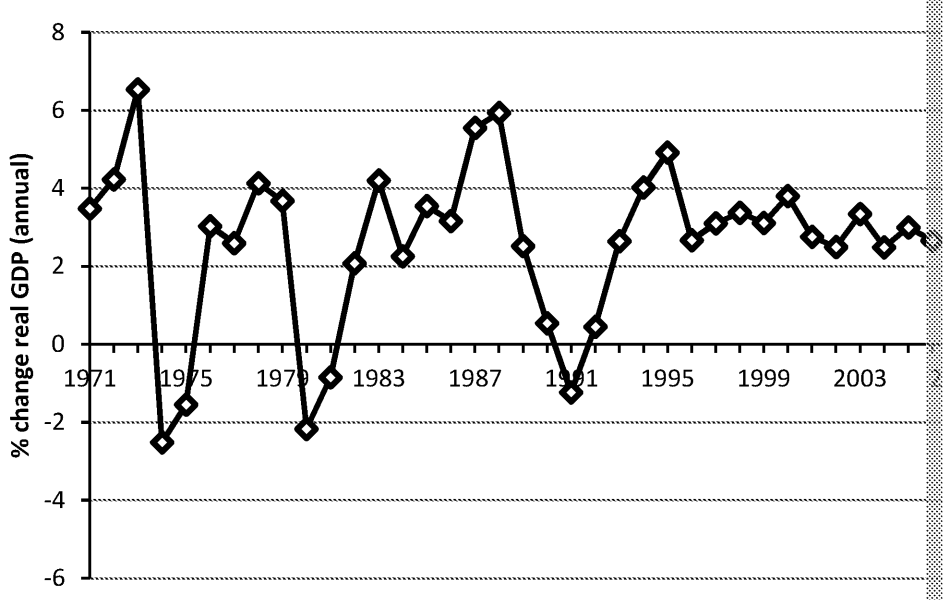
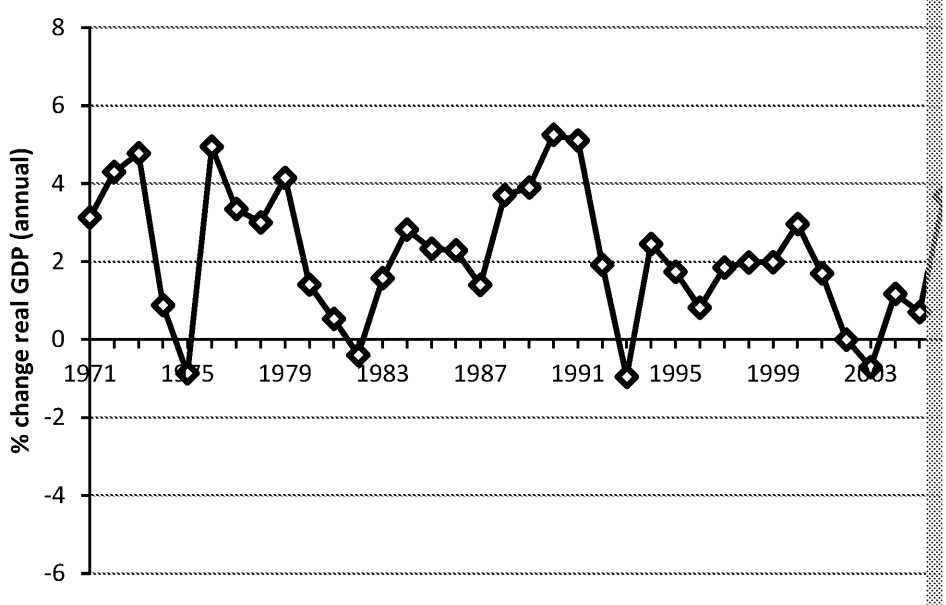


Figure 2: Germany's annual growth rates of GDP



Use the data

1. Identify a period during which GDP growth was fairly stable for both the UK
2. Using Figure 1, estimate the average annual GDP growth rate of the UK ove

Test your knowledge...

1. Describe the trend in GDP growth in the UK during the 1980s.
2. Use a classical AD/AS diagram, with a SRAS, to illustrate the type of output g
   (a) At the peak of a boom
   (b) At the trough of a downturn

Extended-response question

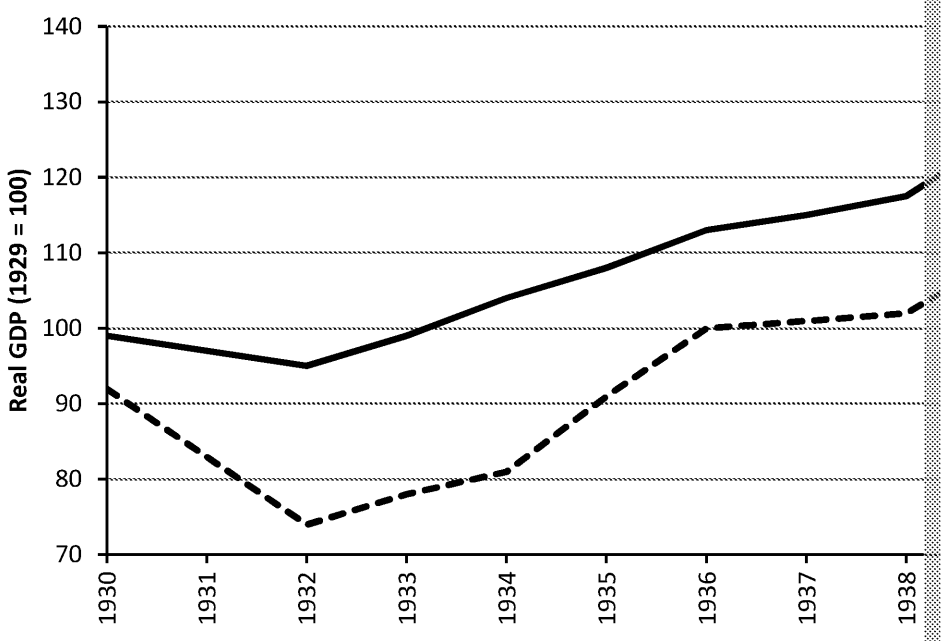
1. Assess the costs and benefits of economic booms.

Monetary and fiscal policy in the Grea

This case study requires knowledge of Section 2.6.2 – deman

The Financial Crisis of 2008 was a global economic disaster, but it is still d
Depression of 1929. The Great Depression was particularly damaging for
also had its fair share of economic misery. The episode provides a unique
study the effects of demand-side policies in an economic downturn. Figu
GDP in the UK and US during the Depression:

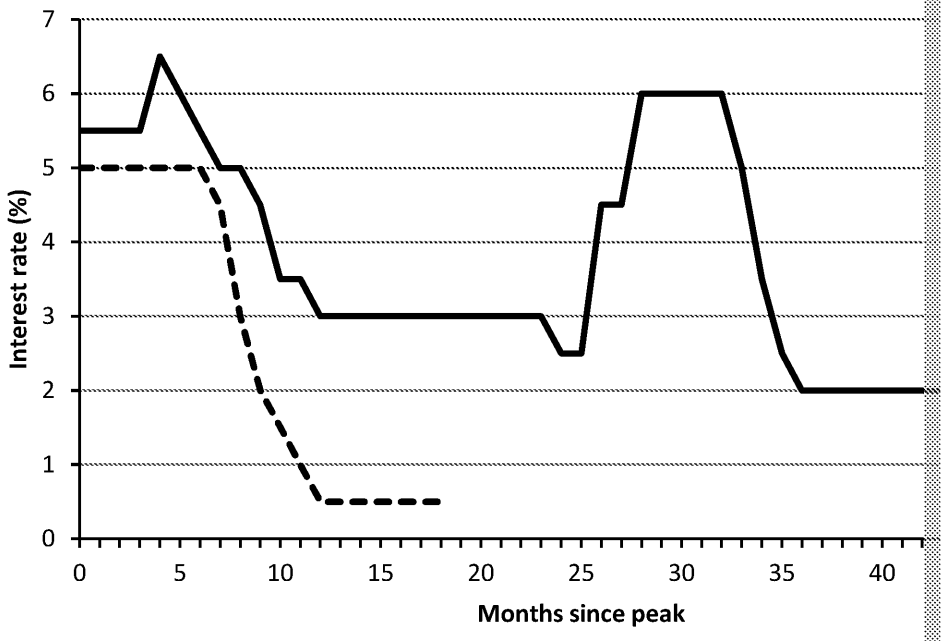
Figure 1: UK and US real GDP 1929–1940



Source: Middleton, (2010), '*British monetary and fiscal policy in the 19*

So what was the UK's monetary policy response to the Depression? Figu
monetary policy: the interest rate.

Figure 2: Bank of England interest rates in the Great Depression (1929) a



Source: Almunia et al. (2009), 'From Great Depression to Great Credit C

It is interesting to note that interest rates were cut much more rapidly during the 2008 crisis than in the Great Depression (this is *expansionary* monetary policy – lowering interest rates should boost aggregate demand). In fact, the central bank increased interest rates in 1931. The reason for this was that the UK was trying to protect the value of its exchange rate, which at the time was tied to the Gold Standard. Decreasing interest rates in this environment would have meant that the pound would depreciate, so more pounds would have been needed to buy the same amount of gold (which would put the UK at a disadvantage with its neighbours). When the UK finally abandoned the Gold Standard in late 1931, the interest rate could safely be cut. This led to a depreciation of the pound, boosting the UK's competitiveness and hence aggregate demand.

In terms of fiscal policy, the government sought to correct the budget defi cutting unemployment benefits and raising taxes. These are *contractionary* slow down the economy. Nevertheless, the economy did recover quite su theory is that because these policies were accepted at the time as 'the right were able to restore confidence in the markets. Another possibility is that was enough to counteract the contractionary effects of fiscal policy. There be drawn between the UK's response here and the response to the Financi

However, economists should be cautious of drawing too many conclusion from the experience of the Great Depression. The complexity of the situat effect of any one policy on economic growth is almost impossible. Further structured quite differently back then. For example, the budget deficit in 1 small relative to the budget deficit seen in 2007. Failing to learn from histo false analogies could be just as bad.

Use the data

1. In which year did the US economy recover to its 1929 levels of GDP?
2. What is the (technical) definition of a recession? Was the UK in a recession
3. From Figure 2, how long did it take for the UK interest rate to fall from 5% t Crisis?

Test your knowledge...

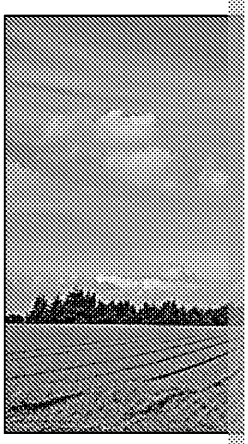
1. Approximately how much larger (in percentage terms) was the UK economy
2. (a) Show the effect of a fall in the interest rate on AD using a Keynesian AD
   (b) Explain two reasons why the fall in interest rates has this effect on AD.

Extended-response question

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

Supply-side policies – privatisation

This case study requires knowledge of Section 2.6.3 – supply

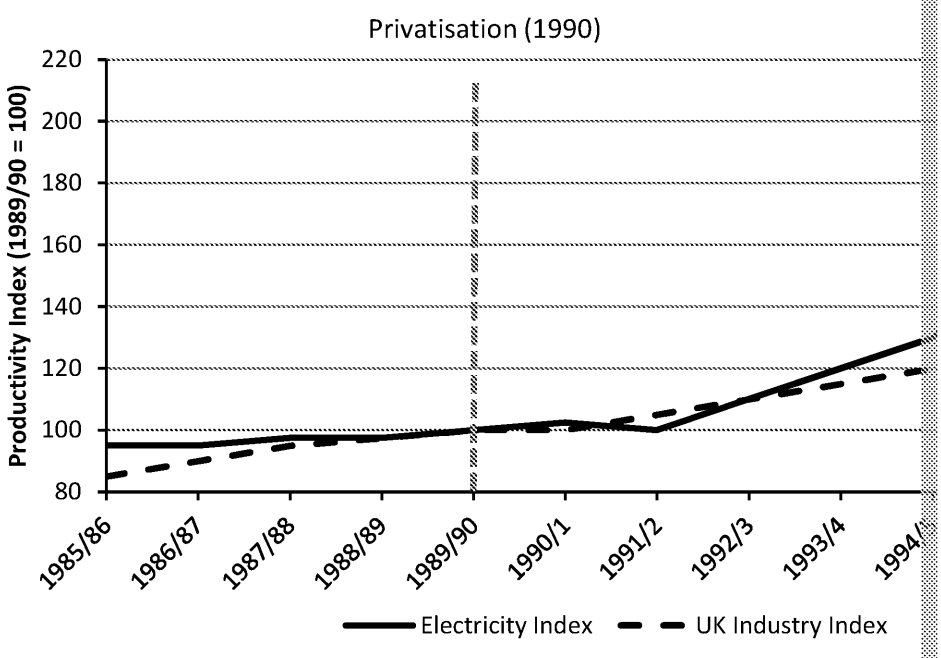


Supply-side policies, such as improving health and education, aim to increase the productive capacity of the economy. This allows for greater long-term economic growth. One of the larger (and more controversial) supply-side projects in the UK was the privatisation of nationalised industries in the 1980s and 90s.

The idea behind privatisation is that it enhances competition in the market, increasing efficiency, as private firms (motivated by profit) run themselves more efficiently than the government can. In the UK, examples of industr include the steel, telecoms, electricity and gas industries (and more recent

Figure 1 charts labour productivity in the electricity sector before and afte a UK-wide industry index:

Figure 1: Labour productivity Index: before and after privatisation



Source: Domah and Pollitt (2000), 'The Restructuring and Privatisation of the Electricity Distribu

Figure 1 does seem to indicate that privatisation had a positive effect on la some argue that this is due to reductions in employment following privati automatically increase labour productivity, ceteris paribus). Supporters o loss of employment in specific industries is offset by gains in employment

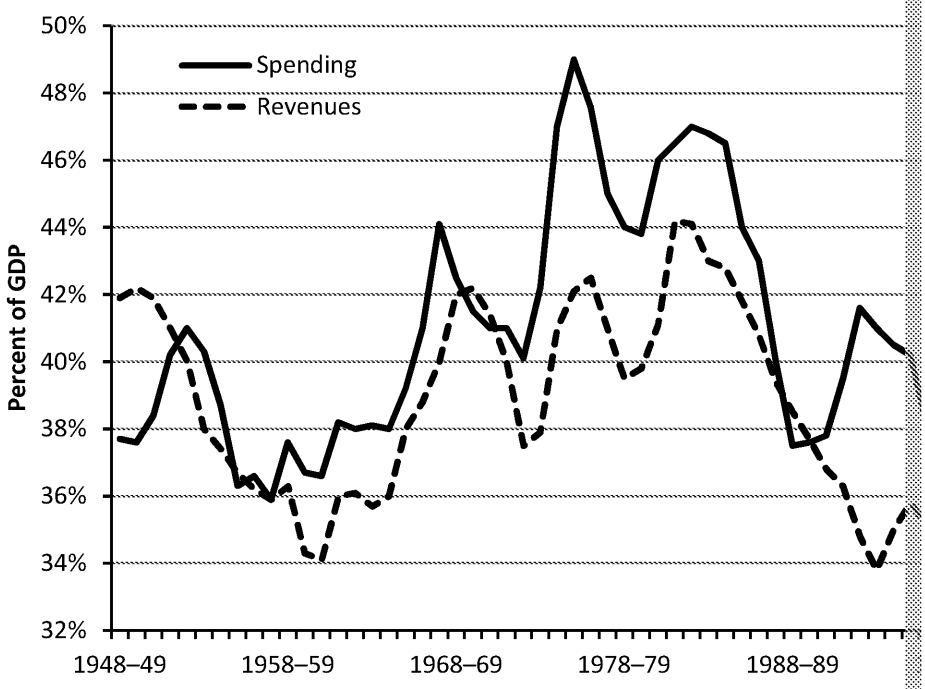
There was fierce opposition to privatisation at the time, causing deep divi that privatisation has failed, because market power has become concentra time, undoing any initial efficiency gains from competition (critics argue t electricity sector in particular, where a small number of firms dominate th

Studying the effects of privatisation is difficult, because it's hard to tell wh
downturns in industries would have happened anyway if there had been
privatisation was the cause of these changes! Most economists agree, thou
privatisation are maximised when there is a genuine competition in the in

The next question on this issue will be how far the NHS will move toward
to depend on whether the current system can continue to support an agei
and whether supporters of privatisation can persuade the public that it wo
profiting from people's ill health.

Figure 2 shows the pattern of government spending and tax revenues ove

Figure 2



Use the data

1. How much higher was the productivity of labour in the electricity sector in 1
privatisation was first introduced?
2. Look at the pattern of government spending during the 1980s in Figure 2. Is
not?
3. Look at Figure 2. What can you infer about the UK's tax rates during the 19

Test your knowledge...

1. From the passage, identify one potential benefit and one potential cost of p
2. Show the effect of a successful supply-side policy on an AD/AS diagram.

Extended-response question

1. 'Governments should focus more on supply-side policies than demand-side
supply-side policies can increase long-term economic growth'. Discuss this

Policy conflicts – inflation and unen

This case study requires knowledge of Section 2.6.4 – conflicts and trade-offs b

Economies rarely seem to perform exactly the way we want them to. If a government tries to correct one problem, they often end up causing another in the process – a 'trade-off'. One of the classic economic trade-offs that has been studied extensively is the conflict between inflation and unemployment. William Phillips, a New-Zealand-born economist, proposed the short-run relationship between inflation and unemployment in the 1950s that came to be known as the Phillips curve.

Figure 1 plots UK inflation and unemployment from 1971–2000 (each dot represents a year):

Figure 1: UK Inflation and Unemployment 1971–2000

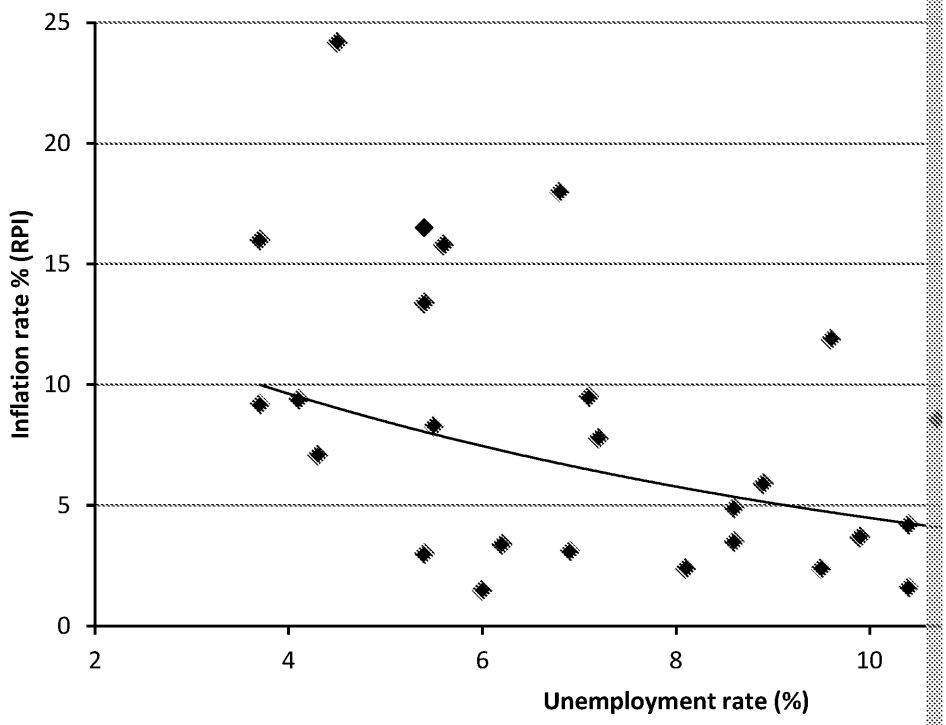
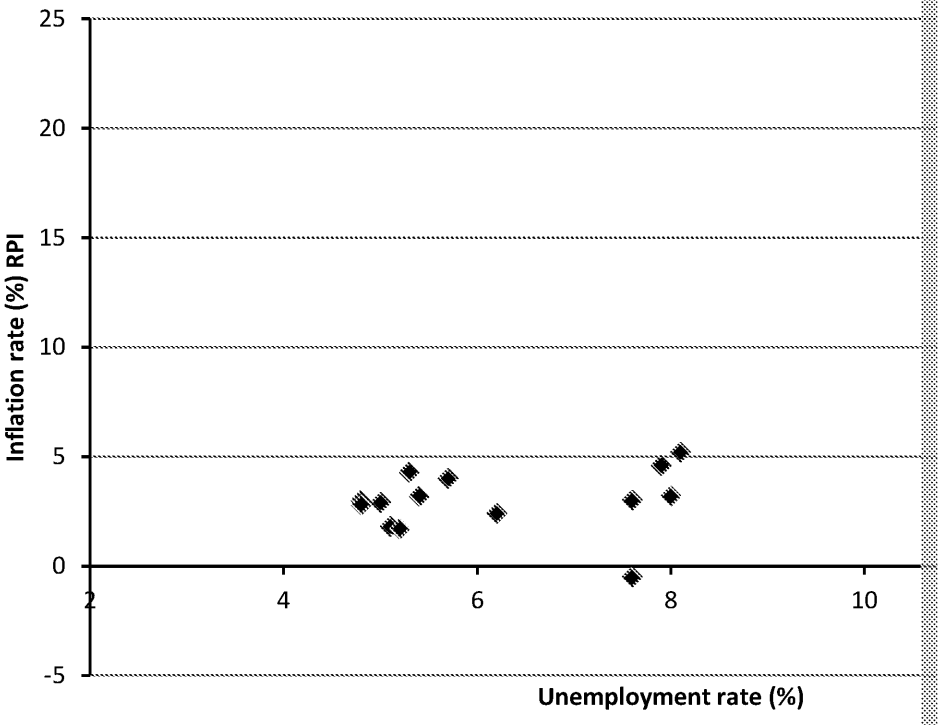


Figure 1 seems to show a rough pattern of the trade-off, although as with it is not nearly as neat as the theoretical Phillips Curve. Inflation is measu doesn't stretch back that far. Data is available for after 2000, but the relati (particularly due to the disruption caused by the financial crisis).

How do we explain this trend line? Take the case of low unemployment a scenario almost everyone in the labour force is employed, so firms have to workers. This pushes up inflation (cost-push). Furthermore, when wages increase, pushing up demand for goods and services. This pushes up the The opposite happens when unemployment is high and inflation is low.

However, it has been argued (and observed in the data) that the Phillips C
down over time. In the UK, after the financial crisis we have seen low une
(see Figure 2). This could be explained by the success of supply-side polic
that expand the productive capacity of the economy (limiting inflation). T
targeting policy (which only came into force in the 1990s) may be another
of the relationship. This is good news for governments – as long as the tre
inflation continues, and we don't return to the 'stagflation' seen in the UK
and high unemployment).

Figure 2: UK Inflation and Unemployment 2001–2014



Use the data

1. Sketch the Phillips Curve.
2. Look at the trend line in Figure 1. Suppose unemployment was at 9%. If un
percentage points, what would be the expected change in inflation?
3. Which of these best describes the relationship between inflation and unemp
(a) positive relationship, (b) negative relationship or (c) no relationship?

Test your knowledge…

1. Explain why high unemployment may lead to low inflation.
2. Explain two other possible policy conflicts.

Extended-response question

1. *'Governments should prioritise low unemployment over low inflation.'*
Discuss this statement.

When will the UK raise interest

This case study covers a range of Theme 2 topics

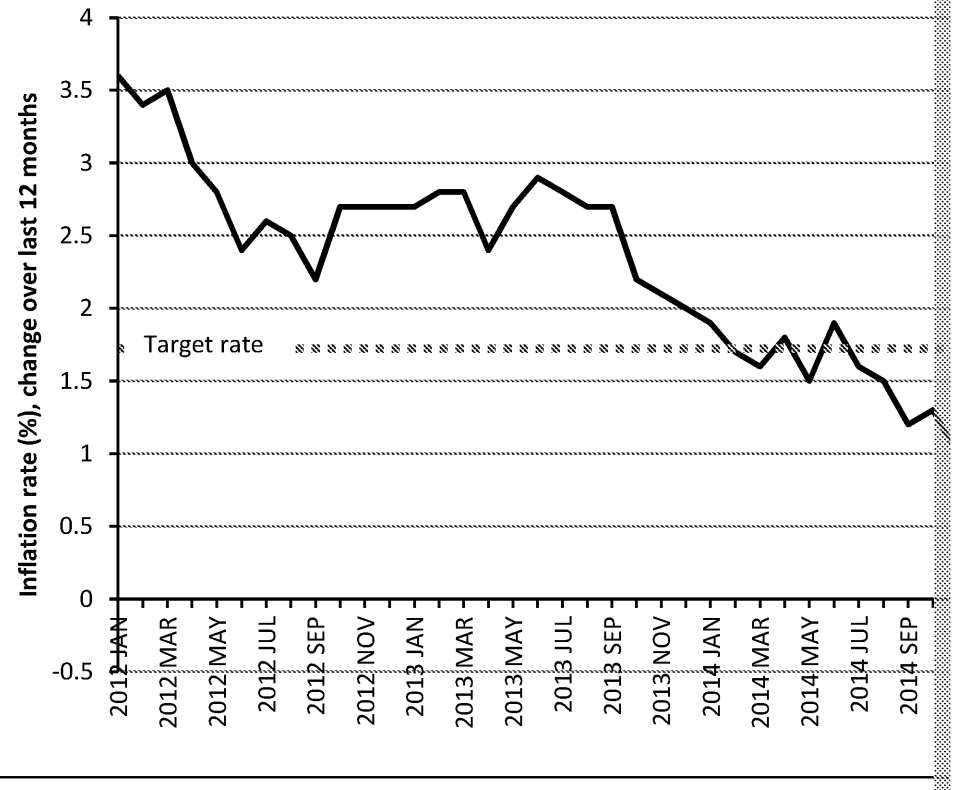
Interest rates are one of the key tools central banks use to guide the economy in the right direction. The Bank of England's Monetary Policy Committee meets every month to decide whether or not to change interest rates. In the UK, interest rates have been at a historic low of 0.5% since March 2009. Financial commentators have been continually pushing back their predictions of when rates will finally go up again.

In Japan, interest rates fell to –0.1% in January 2016 to try to stimulate growth, but the US seems more optimistic: the Federal Reserve inched up the US's interest rate in December 2015. The UK seems to have recovered from the recession, so why haven't interest rates gone up here as well? Mark Carney – the Canadian-born go – is concerned about an array of economic risks facing the country in 2016

The main worry is that a combination of low oil prices and a fall in China' that the global economy will have a weak year. The UK is highly integrate (more so than the US), so it will certainly be affected by an economic slow

Another factor is the inflation rate. Traditionally, monetary policy is desig stable, positive rate. As Figure 1 shows, the UK has seen unusually low in years.

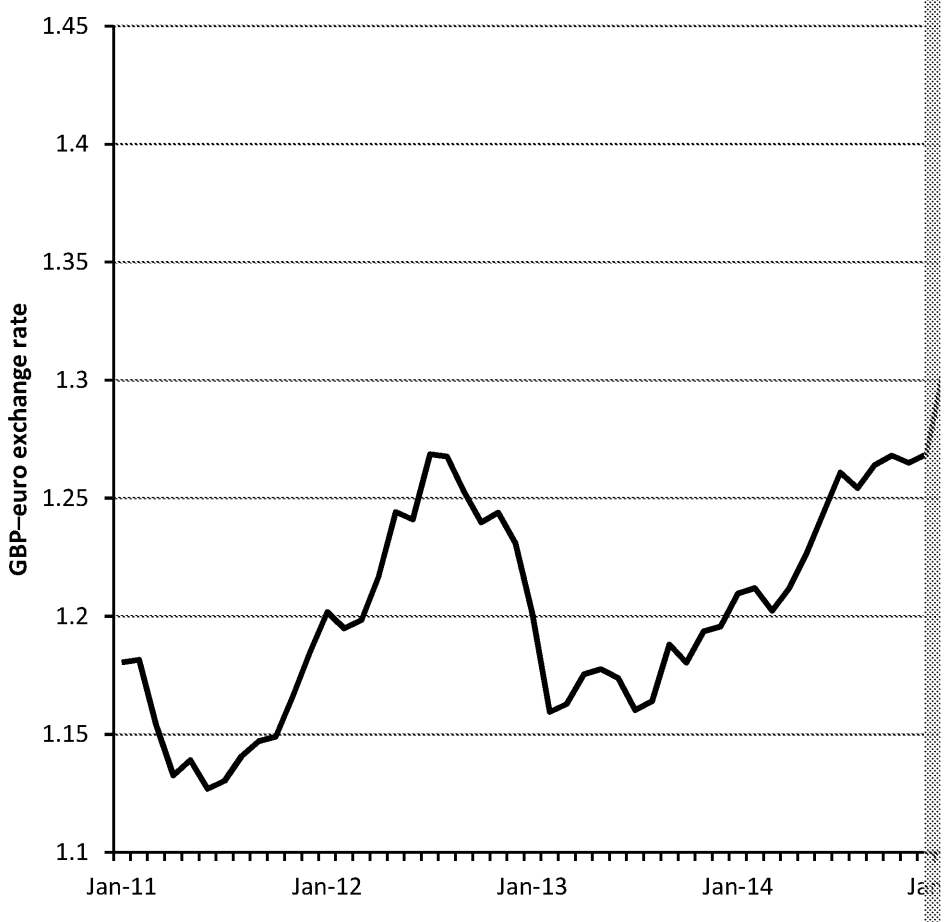
Figure 1: UK CPI Inflation 2012–2015



It is feared that if interest rates are hiked too soon, the result could be defl

Related to this is the UK exchange rate (see Figure 2). The pound was rela
it has been falling because of uncertainty about the UK's referendum on E

Figure 2 – GBP–EUR exchange rate (value of £1 in euros, monthly avera



There is another difference between the UK and US economies that may e
rates: fiscal policy. In the UK, the government is pursuing contractionary
budget deficit. The US, in contrast, has relatively expansionary fiscal polic

Use the data

1. Which of the following terms best describes the trend in Figure 1: (a) disinfl
(c) deflation?
2. Explain why deflation might be damaging for an economy.
3. Suppose the GBP–EUR exchange rate is 1.15 (as in early 2013). In this case,
pounds?

Test your knowledge...

1. Give two reasons why the UK inflation rate might have been falling (Figure 1
2. (a) Explain how an increase in the interest rate would be expected to affec
(b) Explain the main consequences of the change in the exchange rate for

Extended-response question

1. Assess the effectiveness of lowering interest rates to stimulate economic gr

Answers

Mark scheme: extended-response questions

10 marks

		Knowledge (2), application (2) and analysis (2)
	0	No relevant answer given.
Level 1	1–2	A few concepts may be identified correctly, but inconsistently, and wit behind the causes and effects.
Level 2	3–4	Some knowledge of economic concepts is shown, partially linked to th reasoning skills, but may focus too much on one side of an argument.
Level 3	5–6	Knowledge of the economic concepts is very accurate. Links to the qu examples. Analysis is well reasoned and logical, and appropriate for th
		Evaluation (4)
	0	No evaluation.
Level 1	1–2	Limited attempt at evaluation – may be only loosely related to the que reasoning.
Level 2	3–4	Accurate, balanced evaluative comments are made, supporting a roun directly to the question.

15 marks

		Knowledge (3), application (3) and analysis (3)
	0	No relevant answer given.
Level 1	1–3	A few concepts may be identified correctly, but inconsistently, and wit behind the causes and effects.
Level 2	4–6	Some knowledge of economic concepts is shown, partially linked to th reasoning skills, but may focus too much on one side of an argument.
Level 3	7–9	Knowledge of the economic concepts is very accurate. Links to the qu examples. Analysis is well reasoned and logical, and appropriate for th
		Evaluation (6)
	0	No evaluation.
Level 1	1–2	Limited attempt at evaluation – may be only loosely related to the que reasoning.
Level 2	3–4	Clear evidence of evaluative comments, though they may be unfairly w argument. Reasoning / supporting evidence is provided but may be in
Level 3	5–6	Accurate, balanced evaluative comments are made, supporting a roun directly to the question.

20 marks

Knowledge (4), application (4) and analysis (6)		
	0	No relevant answer given.
Level 1	1–3	A few concepts may be identified correctly, but inconsistently, and w thought behind the causes and effects.
Level 2	4–6	Some knowledge of economic concepts is shown, partially linked to or basic reasoning skills.
Level 3	7–10	Good knowledge of the relevant economic concepts is displayed, lin evidence to support the main arguments. Analysis is well developed side of an argument.
Level 4	11–14	Knowledge of the economic concepts is very accurate. Links to the c examples. Analysis is well reasoned and logical, and appropriate for
Evaluation (6)		
	0	No evaluation.
Level 1	1–2	Limited attempt at evaluation – may be only loosely related to the q reasoning.
Level 2	3–4	Clear evidence of evaluative comments, though they may be unfairly argument. Reasoning / supporting evidence is provided but may be
Level 3	5–6	Accurate, balanced evaluative comments are made, supporting a rou directly to the question.

Case Study 1: Economic growth in the UK – back to business as usual?

Use the data

1. 2.5% (accept 2–4%)
2. Nominal GDP figures do not account for the effect of inflation, so GDP figures appe positive in the UK). Therefore, the GDP growth figures would be higher (also the re Visually, the graph would appear to have shifted up.
3. USA's GDP growth is given as 2.4% in the text, so from a starting point of $17 trillion (17 * 102.4) / 100 = $17.408 trillion.

Test your knowledge...

1. GDP is the total value of output (or goods and services) produced in an economy (w means the effect of inflation has been removed (1).
2. Possible answers include: market confidence, low borrowing costs, low oil price, re

   1 mark for each identified factor. You cannot have the expansionary monetary poli Statement (since this was after 2014).

Extended-response question

1. GDP measures the total value of output in an economy. When you adjust for popu inflation (real GDP) this can give a good impression of the *size* of an economy. How compare the *success* of different economies, many important factors are omitted:
   - **Living standards**. It can be more informative to adjust GDP using the concept account for different living standards in different countries (PPP should be cle Accounting for living standards tends to narrow the perceived gap between ri are usually relatively cheap in poorer countries.
   - **Inequality**. Even per capita GDP figures give no indication of the distribution o experience rapid economic growth, but this would not benefit the general pop to a small elite.
   - **Negative externalities**. GDP only measures the total value of output, it doesn 'bad' output. Economic growth may come hand in hand with environmental d of land for commercial purposes.
   - **Happiness**. Having a higher average standard of living does not guarantee tha end up working excessively long hours and spend less time with their families. wealth increases happiness up to a point – but increasing wealth beyond that This is notoriously difficult to measure, however.

In your answer you could also make reference to 'composite' indicators such as the
of factors before comparing countries' performance (with respect to economic dev
that GDP does not account for the size of the 'black economy' (unrecorded or illicit
greatly between countries. A good answer should explain at least two or three of t

Case Study 2: UK inflation in the 1970s

Use the data

1. Around 27% (in 1975). Accept 26–28%.

2. (a) Inflation fell from around 22% to around 5%, a fall of 17 percentage points (an
percentage points is acceptable).
(b) This is known as disinflation – a reduction in the rate of inflation (not to be co

3. Inflation in 1970 was around 5%, but increased rapidly to a peak in the middle of th
around 7–8% before climbing again towards the end of the decade to around 22%.

Test your knowledge...

1. The passage notes the increase in oil prices and low interest rates (also known as lo
of these earns 1 mark.

2. Deflation is when the inflation rate is negative, i.e. when prices are falling (1). Disin
inflation (e.g. from 5% one year to 3% the next) (1).

Extended-response question

1. Your answer should explain clearly several costs of inflation, before assessing their
whether inflation can be beneficial in some ways). Possible costs of a high rate of i
   - **Uncertainty**. Consumers might postpone economic activity, given how rapidly
   Businesses will be unclear about their costs of production, and may have diffic
   (**menu costs**).
   - **Shoe-leather costs** (cost to consumers of having to compare prices more ofte
   - **Reduces value of savings / fixed incomes**. Inflation creates winners and loser
   suffer a fall in their wealth, as will those whose incomes do not automatically
   - Possible **wage-price spiral** (if inflation is high, it leads to workers negotiating w
   prices, higher inflation, and so on)
   - **Fall in international competitiveness** (inflation is a sign of economic weakness
   investment, and the price of exports appears inflated)

An evaluative point you could make is that the costs depend on how high the rate of infl
(higher and more prolonged periods of inflation are more damaging).

As another evaluative point you could explain that a low and stable rate of inflation is co
since it acts as a gentle encouragement for people to spend money (which boosts econo

Case Study 3: UK unemployment – successes and challenges

Use the data

1. The main explanation is that the claimant count ignores those who are unemployed
benefit for various reasons (e.g. too much hassle to claim, don't like the stigma of c

2. 55% of 60 million is 33 million (size of the labour force). Figure 2 tell us that the ma
was around 6%, so that means that 1.98 million men were unemployed (6% of 33 m

3. The graph shows that male employment rates are higher than female employment
narrowing over time (the gap in 1990 was roughly 20 percentage points, in 2015 th
percentage points). The gap could be explained, for example, by the fact that wom
care for children. The narrowing of the gap seems to be down to greater employm
has remained fairly steady), perhaps due to a shift in societal attitudes.

Test your knowledge...

1. Economically active people are those that are either working (employed) (1) or look
number of economically active people is the same as the size of the labour force. Y
people count as economically active to get the full two marks.

2. Possible answers include: structural unemployment, demand deficiency / cyclical u
type of unemployment, 1 mark for explaining how it works.

Extended-response question

1. Your answer should discuss the significance of several consequences of unemploym
and economic costs.

Possible **economic** consequences include:

- Fall in tax revenue and/or increase in unemployment benefit spending (which
budget deficit). This has knock-on effects on the economy: it could lead to a r
government spending in other areas.
- Loss of economic growth (lower output/GDP due to less work, plus fall in cons
- Costs to the unemployed themselves: economic costs (lower living standards)
costs, loss of skills). Could mention that the longer someone is out of work, th
There are fears in countries such as Spain and Italy of a 'lost generation', since

Social costs include crime and various health problems.

Case Study 4: Should we be worried about the UK's current account deficit?

Use the data

1. (a) Secondary income (or net international transfers)
(b) Primary income (or net investment income). Despite the fall in the deficit in 2
been clearly downwards.

2. (a) £49.6 billion (3.1% of 1,600 billion)
(b) £94.5 billion (5.4% of 1,750 billion)

Test your knowledge...

1. (a) This would represent an improvement in the net investment income balance –
would improve (i.e. become closer to a surplus). 1 mark for improvement in n
1 mark for current account balance improvement.
(b) Since the extract states that the UK is a net importer of oil, an increase in price
worsening the net trade component of the current account balance (i.e. great
cost of imports, 1 mark for worsening of current account balance.

An alternative answer could be: rising oil prices may reduce the demand for oi
imports may fall (1), which may lead to no effect on the current account (or a
However, this may not be the case since oil is a necessity in most countries (1)
elasticity of demand.

Extended-response question

1. The main benefit of this strategy is that it should boost the amount of exports from
(ceteris paribus). This strategy is likely to be more successful if it focuses on an indu
well in. A good answer should explain this clearly, before discussing some of the po

- Opportunity cost involved
- Possible x-inefficiency (from micro-problems with subsidies reducing the effici
- If other countries are more competitive in these markets, this strategy may no
compete with countries such as China, which benefit from low unit labour cos

Other evaluation points you could mention include: success depends on the world e
initial size of the export sector receiving the investment.

You should come to a conclusion as to whether you think the policy would be succe
which it would / would not be successful). You can be for or against the idea, provi

Case Study 5: The UK's slump in consumption during the recession

Use the data

1. This data is in real terms – you can tell because 2008 is used as the base year (this n
relative to 2008).

2. The index in 2009 Q3 is at about 93 – this indicates a fall of 7% from 2008 Q3. 6–8%

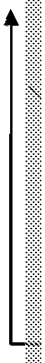
3. This is a bit of a trick question – you can't tell from the graph which type of spending w
actual amounts of spending involved – only the percentage changes (Note: questions

Test your knowledge...

1. AD = C + I + G + (X – M). Answers in symbols or words are both acceptable.

2. Household spending fell from a peak of around £225 billion in 2007 Q4 to a low of around £211 billion in 2009 Q2, a fall of about £14 billion. Answers between £13 and £15 billion are acceptable.

3. Diagram should show a shift to the right in aggregate demand: this is because a fall in VAT (which is a tax on consumer goods) encourages consumption (the main component of AD). Up to 2 marks for correct labelling, up to 2 marks for showing the shift correctly.



Extended-response question

1. A good answer must explain how both interest rates and consumer confidence can affect aggregate demand.

   Interest rates: A fall in the interest rate makes saving less attractive and borrowing cheaper. This should boost consumer spending. You could also exp (businesses will seek to invest elsewhere, rather than in interest-bearing assets), an (lower interest rates depreciate the exchange rate, since it becomes less attractive Therefore, exports increase and imports fall – boosting aggregate demand).

   Consumer confidence: If consumers are confident about the outlook for the econo healthy levels of spending. The same goes for business confidence and investment

   Both are clearly important elements of a strategy to boost consumption. However, points that can be made:

   - Interest rates (usually) can't go below zero. Since the current rate of 0.5% is s rates can no longer be of use.
   - Consumers may want to save no matter how low interest rates are if they beli high.
   - Changes in interest rates have a delayed effect on aggregate demand (time lag
   - Consumer/market confidence cannot be directly controlled by the governmen perceptions of how well the economy is doing, and how competent the gover

   A good conclusion should note that both of these factors are important in determin part of a wider approach to tackling the problem (i.e. they won't be nearly as effect make an argument that one factor is more important than another, as long as it is v

Case Study 6: The economics of immigration

Use the data

1. Around 1983 (emigration exceeded immigration in one or two years after that, but rule).

2. (a) Around 200,000 (accept 175,000–225,000)
   (b) Around 0. (accept –25,000–25,000)

3. The labour force participation rate would increase.

4. The labour force participation rate would worsen, as the 'bulge' from the migration (retire).

Test your knowledge...

1. Immigration was roughly 590,000 and emigration was roughly 340,000, so net migr answer between 225,000 and 275,000 is acceptable for 1 mark.

2. Between 1964 and the mid 1980s, net migration was usually small and negative. D to climb at a faster rate than emigration, and net migration became positive and la period of negative net migration, 1 mark for identifying period of positive net migra

3. Possible answers include:
   - Technological advance
   - Improvements in productivity
   - Improvements in education and skills (human capital)
   - Regulatory changes / competition policy changes

   Other answers are possible so long as they are well justified: 1 mark for stating eac can increase LRAS.

Extended-response question

1. There are several points in the article that you can mention, both for and against th include:
   - Increasing size of the labour force (evaluation point: more effective in countrie more of a problem, e.g. Japan)
   - Bring broader range of skills (e.g. technical skills, language skills) – boost to hu depends on skill composition of migrants)
   - Migrants may be harder workers or contribute disproportionately towards inc native workers (e.g. NHS. Evaluation point here is that migration is more bene shortages either generally, or in specific sectors.)
   - Potential to foster better trade relations between sending/host countries

   Points against could include:
   - Overcrowding / undesirable population growth (evaluation point: particularly shortage of housing supply such as the UK)
   - Diminish labour market opportunities for native workers through lower wages points: only applies when there is a shortage of jobs to begin with, could be m brought by migrants)
   - 'Brain drain' effect from sending countries (when countries lose their best and remittance payments back to families)

   Although they are not direct economic issues, you could also point out potential so arise from migration. This could be mitigated by government policies to integrate r to draw an AD/AS diagram to show the increase in AS from migration (and a possib

   You can be either for or against the policy in your conclusion, but for Level 3 evalua contexts in which the policy could be successful/unsuccessful.

Case Study 7: Investigating the multiplier effect

Use the data

1. Answers can be within £0.5 billion of the answers stated here:
   (a) 1.5 * 2 = increase of £3 billion
   (b) 1.5 * 3 = increase of £4.5 billion
   (c) 1.5 * 1 = increase of £1.5 billion
   (d) 1.5 * -1.8 = decrease of £2.7 billion

2. Increasing government spending is predicted to cause inflation due to a shift to the cheaper and exports more expensive, reducing the demand for domestic goods (the domestic currency) which causes the exchange rate to depreciate.

   Another possible reason is that government spending crowds out private investmer abroad, depreciating the exchange rate.

3. The idea here is that government spending 'crowds out' private investment (i.e. red investment opportunities available to the private sector), decreasing investment.

Test your knowledge...

1. Government spending increases the G component of AD, shifting AD to the right. This should lead to inflation using the standard AD/AS framework. Note that using a classical (vertical) LRAS curve is equally valid. 2 marks for correct labelling, 2 marks for showing shift in AD and resulting increase in inflation.

Price Level (£)

2. The trend for the baseline case is that output falls over the first two years, before slowly reverting back to normal. The trend for the recession case is the complete opposite: output increases (initially at 2%), before gradually falling after two years. 1 mark for correction description of each trend.

P_2

P_1

Extended-response question

1. Taxes represent a withdrawal from the national flow of income, so raising taxes is likely to reduce the size of the multiplier. So, even if government sp the economy may be relatively small. You could use an AD/AS diagram to show tha the left (via a fall in consumption and/or investment, depending on the type of tax)

On the plus side, you could argue that the boost from government spending would particularly if the higher taxes were well targeted, or increased only slightly (so that dramatically). If the national debt or budget deficit was particularly high, you could seen as a sensible policy, inspiring market confidence.

Evaluative points could be that there is a time lag between raising taxes and seeing policy wouldn't help fix the recession until further into the future (it may worsen th that it might make more sense for the government to borrow the money, and repay improves (since borrowing money is likely to withdraw less from the economy than extend the loans).

You can conclude that the policy would be successful or unsuccessful, so long as it i the article and standard theory, the evidence seems to suggest that it would be uns

Interestingly, raising taxes in a recession was one of the policies implemented by th Depression in the 1930s – and the general consensus is that the policy was disastro

Case Study 8: Patterns in the business cycle

Use the data

1. The mid 1990s to early 2000s seems to be the most stable (continuing into the mid period of stability in the USA, leading to some economists speculating that the natu changed. They seem to have been proved wrong by the volatility seen in the late 2

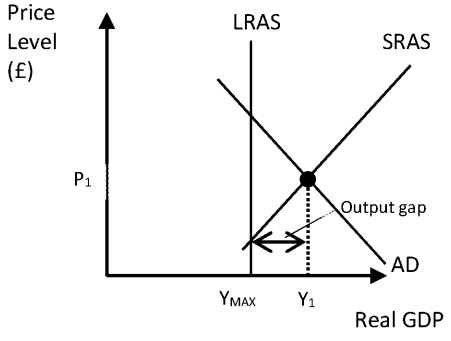
2. The average annual growth rate is 2.3%. This is hard to estimate visually from the g and 3% is a good guess.

Test your knowledge...

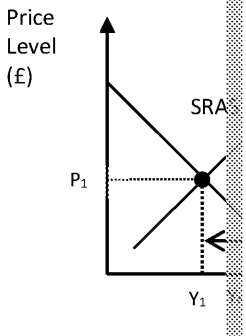
1. The 1980s was a very volatile decade for growth in the UK (1), with GDP growth sw 2% in the space of one year in the early part of the decade. Following a recession, G 1988 (1) before falling rapidly again.

2. In case (a) the economy may be experiencing a positive output gap (it is also accept maximum, i.e. output gap of zero). In case (b) the economy is likely to be experienc diagram, 1 mark is for labelling, 1 mark is for drawing the curves in the right places, correct type of output gap. Note that this scenario can also be drawn using a Keyne

(a) Positive output gap



(b) Negati



Extended-response question

1. The main benefit from economic booms is higher rates of economic growth. Econo living standards. Booms are also associated with low unemployment, avoiding the Economic growth should also improve the government's finances as tax revenues ir automatically improving a budget deficit. The country may also benefit from inflow if interest rates are high.

   There are several potential downsides to economic booms, however. Firstly there m which can have a variety of negative effects on the economy. Furthermore there m certain markets (e.g. housing). When these bubbles burst, the subsequent recessio booms may also be associated with environmental damage, depending on which in

   To get higher marks you must assess both the benefits and the costs of economic b

Case Study 9: Monetary and fiscal policy in the Great Depression

Use the data

1. 1936 (since the index has returned to 100)
2. A recession is defined as two consecutive quarters of negative GDP growth. Figure recession, as GDP fell consistently from 1930–1932.
3. 6 months

Test your knowledge...

1. Around 34% larger (index number of 134). 32–26% acceptable.
2. (a) Your graph should show a shift to the right in AD. 2 marks for correct labelling (you should show new price level and real GDP level). 2 marks for showing the shift correctly.
   (b) Possible reasons include: higher consumer spending, higher investment, higher net exports. 1 mark for stating the reason, 1 mark for explanation of how it works (e.g. higher consumption and investment because saving is less worthwhile, higher net exports because exchange rate depreciates as fewer people choose to save pounds).

Pri
Lev
(£)

Extended-response question

1. Your answer should explain how at least two or three demand-side policies can incr least one monetary policy and at least one fiscal policy). You could include an AD/A refer to the diagram you drew in Question 2. You should also note some of the dra example:
   - Lowering interest rates should increase economic growth, since it increases th (as explained in Question 2). Evaluation: this is only effective up to a point (in zero), and there may be a time lag between changing the rate and seeing an e also depreciate the currency, which could be damaging for countries which re
   - You could also mention increasing the money supply, which has similar effects However, this could lead to inflation (this is a general criticism of demand-side currency.
   - Government spending is an example of fiscal policy that can stimulate growth, Its success may depend on the size of the multiplier. However, this spending l lead to a rise in the budget deficit / national debt. There may also be a substa Another potential evaluative point is that government spending could 'crowd
   - Lowering taxes is an expansionary fiscal policy, as it encourages greater econo depend on the nature of the tax cut (some taxes target particular types of acti Also, lowering taxes could reduce tax revenues, leading to a worsening of the argue that it would actually increase tax revenues: Laffer curve).

   A general criticism you should mention is that demand-side policies can lead to infl economic growth in the long term. Here, you could note that the rate of inflation n supply is increasing or not. You may reason that demand-side policies are best use normal economic times, since there is more likely to be an output gap.

   You don't need to mention all these points to reach a high-level answer. You shoul points in good detail.

Case Study 10: Supply-side policies – privatisation in the UK

Use the data

1. The index shows about 200 compared to 100, so labour productivity is twice as high
2. Figure 2 shows a sharp fall in government spending, which is exactly what you woul privatisations (since the government is no longer funding these industries). The fall to do with this, or perhaps to do with the tax cuts under the Conservative governm
3. The 1970s shows very high spending and tax revenues as a percentage of GDP. One during this period (particularly income tax) were significantly higher than they are t

Test your knowledge...

1. The main benefit is any gains from competition (efficiency) (1). The costs identified are loss of employment in industries (1), and the divisions in society caused by privatisation.

2. Your graph should show a shift to the right by LRAS: 2 marks for correct labelling (including new price level and real GDP levels), 2 marks for showing shift correctly. Classical LRAS diagrams are equally acceptable.

Price Level (£)

P_1

P_2

Extended-response question

1. Your answer should identify the purpose of each type of policy. For example:

   Demand-side policies: used to influence AD, contribute more to short-run economi growth, particularly useful in recessions.

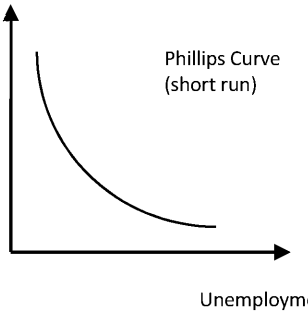
   Supply-side policies: used to influence AS, essential for long-run economic growth, high short-term opportunity cost.

   A good answer should probably reason that it's not a question of choosing one type types of policies serve different functions, so both are important for economic pros policies are changed all the time). In your answer you could use an AD/AS diagram also point out some advantages and disadvantages of specific types of policy (e.g. t on the supply side, or the arguments around changing tax rates on the demand side

Case Study 11: Policy conflicts – inflation and unemployment

Use the data

1.



2. When unemployment falls by three percentage points to 6%, the trend line shows t (2.5% points higher than the 5% predicted at 9% unemployment).
   Note that the trend line only provides an estimate based on this data: the result pr reality.

3. (c) No relationship. A positive relationship would be upward sloping; a negative rela sloping. The standard Phillips Curve shows an 'inverse relationship'.

Test your knowledge...

1. When unemployment is high, firms can lower wages and still attract workers (1). W inflation falls (1). You could also note that when unemployment is high, incomes fa fall.

2. The main other policy conflicts are: economic growth and inflation, economic grow economic growth and environmental protection, economic growth and inequality. mark for explaining how each one works (e.g. high economic growth can lead to de marks for other policy conflicts if they are well justified.

Extended-response question

1. Your answer should note that allowing either inflation or unemployment to get out near-zero unemployment means that inflation ends up at 30%, then it would proba unemployment to bring down inflation. Similarly, having very low and stable inflati cause serious problems for the economy. Having more of a balance is preferable.

   As part of your answer you should discuss some of the costs of inflation and unemp inflation is actually considered good if it is stable and low (the Bank of England targ unemployment should be focused on slightly more than inflation, since the effects universally negative.

A good evaluative point would be that the question assumes that there is always a
unemployment. As the passage states, there may have been a breakdown of the P
in which case there is less need for the government to balance the two issues (they

Case Study 12: When will the UK raise interest rates?

Use the data

1. The answer is (a) disinflation. This is a reduction (fall) in the rate of inflation. Altho
deflation (e.g. April 2015), this does not describe the majority of the period.

2. Deflation can reduce economic growth, since the value of money is increasing rathe
people to hold onto money, reducing demand, and potentially leading to further de
falls, GDP growth falls, unemployment increases and tax revenues fall: all of these c

3. If £1 = €1.15, then €1 = (1 / 1.15) = £0.87 (rounded to nearest penny). Therefore, €
£43.48 – £43.50 to allow for rounding.)

Test your knowledge...

1. Possible reasons could include: low aggregate demand (or low components of AD, e
falling oil/energy prices, slow wage growth, strong exchange rate (which leads to lo
point.

2. (a) An increase in the interest rate would be expected to appreciate (strengthen)
because it becomes more attractive to save in pounds (1).
(b) An appreciation of the exchange rate would be expected to reduce exports (1)
It would also be expected to increase imports (1), since the purchasing power
effect of this is a worsening of trade balance (or widening of the trade deficit)
mention that this could result in higher unemployment.)

Extended-response question

1. Your answer should first explain how lowering interest rates can stimulate growth (
investment, increase in net exports via depreciation of currency, etc.). You should t
of lowering interest rates alone, based on the passage and your own knowledge. P
- Time lag between changing interest rates and change in other economic variat
- Zero-lower bound for interest rates (although Japan has broken this unwritten
- There are situations when lowering interest rates is not enough to kick-start g
instruments such as quantitative easing, or fiscal policy such as government sp
- Low interest rates are supposed to discourage saving, but if households and fi
reduce their debts), then they may end up saving anyway. This was the case i