Zig Zag Education

**Economics**

A Level | AQA | 7136


# Data Response Case Studies

## For A level Year 2 AQA Economics

## Macroeconomics: The National and International Economy

zigzageducation.co.uk

POD 7092

# Contents

# Teacher's Introduction

This resource is designed to be used for teaching A Level AQA Economics 4.2: The economy. The resource consists of 12 Data Response Case Studies intended for as homework tasks.

The case studies are presented in specification order, collectively covering each t and revising the main topics from lower sixth. Each case study contains detailed and data), and tasks and 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 macroeconomic components of stimulate an interest in the real-world applications of macroeconomics. Each ca introducing the student to a fascinating array of contemporary and historical issu economy.

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

| Case Study | Spe |
|---|---|
| 1. Youth unemployment in Italy | 4.2.3.2 – employm |
| 2. Policy conflicts – inflation and unemployment | 4.2.3.4 – possible macroec |
| 3. Understanding government bonds | 4.2.4 – financial |
| 4. Central banking: the BoE and the ECB | 4.2.4 – financial |
| 5. Market failure in the financial sector | 4.2.4 – financial |
| 6. Canada's economic policies | 4.2.5.1 – fiscal pol |
| 7. Productivity – the key to long-run growth? | 4.2.5.2 – supply-si |
| 8. Ireland's housing market bubble | 4.2.5 – fiscal pol |
| 9. World economic superpowers: is the USA's reign over? | 4.2.6 – the inter<br>4.2.1.4 – uses of n |
| 10. Brexit and trading blocs | 4.2.6.2 – trade |
| 11. Subtle protectionism | 4.2.6.2 – trade<br>4.2.6.3 – the balan |
| 12. Mozambique – an African lion? | 4.2.6.5 – economi |

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

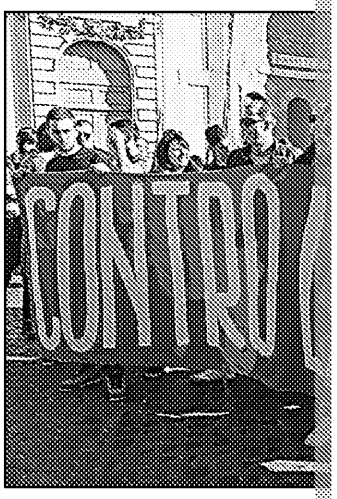
**Free Upda**

Register your email address to rece made to this resource or other Econ has purchased, and details of any * resulting from minor specification chan and peer reviews, or occasional erro

Go to **zzed.uk/fr**

# Youth Unemployment in Ita

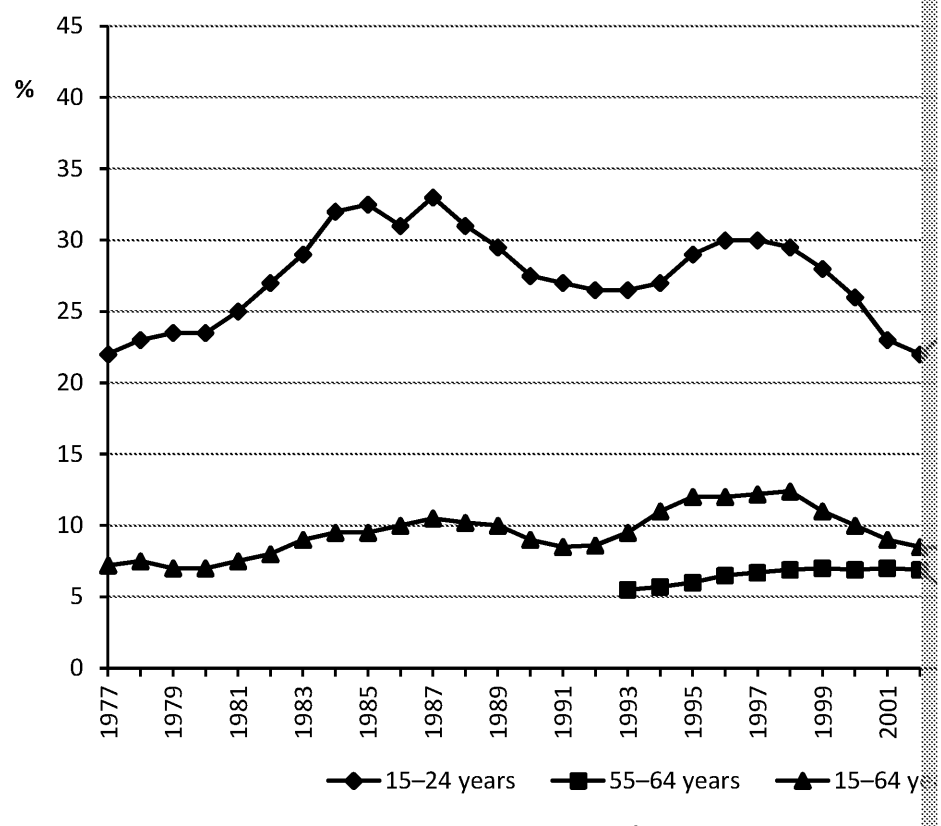
*This case study requires knowledge of Section 4.2.3.2 – employment*




The economic crisis of 2008 had many short-term consequences – banks needed bailing out, monetary and fiscal policy needed loosening, firms needed to lay off workers. Although the general consensus is that the worst of the crash seems to be over, some problems look set to persist in the long term. For some Eurozone countries, few issues are more worrying than that of youth unemployment.

Italy's overall unemployment rate hit a high of 12.4% in 2013. This alone is cause for concern, compared with rates of 7.7% and 5.3% for the UK and Germany respectively (both of which fell continuously through to shows, when Italy's unemployment rate is broken down by age, the result

**Figure 1: Unemployment Rates**




Source: 'No Country for Young People? Youth labou

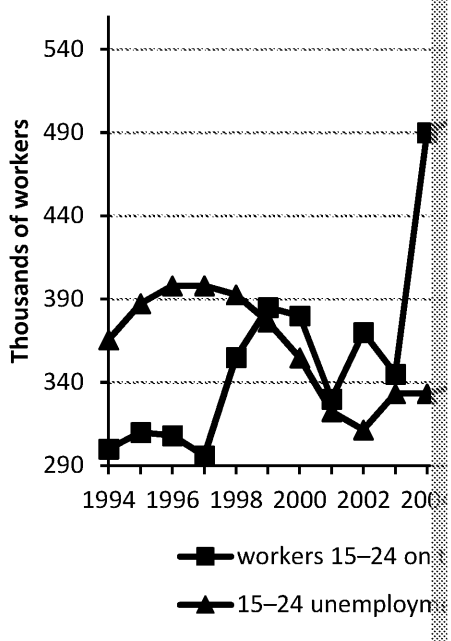
Research conducted by the Centre for Economic Policy Research (CEPR) s
explanations for the rise in youth unemployment rate:

1. The system protects existing, older workers, with young people typica
   temporary (fixed-term) contracts (see Figure 2).
2. More young people chose to go into higher education – this decreases
   young (since those in education don't count as part of the labour force
   increases the unemployment rate, ceteris paribus.
3. Although there have been difficulties for low-skilled NEETs, (Not in E
   Training), there have also been difficulties for graduates. University r
   young people study to degree level, but the supply of available gradu
   economic terms, this is referred to as structural unemployment.

The fear is that if young people are unemployed for too long, they will struggle to adjust to the world of work throughout their lifetime ('lost generation'). Furthermore, there is some evidence of a 'brain drain', as young people emigrate to seek more promising job opportunities.

It is clear that the Italian government will need to find a far-reaching strategy to combat the youth unemployment problem – before it gets any worse.

**Figure 2: Temporary Contracts and**




Source: 'No Country for Young People? Youth labo

## Use the data

Using data from Figure 1:

1. Compare the trend in unemployment for the 55–64 age group with the 15–

Using data from Figure 2:

2. (a) By how much did the number of temporary contracts change between
   (b) Describe the trend in the unemployment rate between 1994 and 2007.
3. Describe a potential policy that could be used to try to fix the youth unempl
   some limitations or disadvantages of your policy.

## Test your knowledge…

1. One of the reasons for the rise in youth unemployment was that more youn
   study, rather than participating in the labour force. Explain how this leads t
   using the formula.
2. State two types of unemployment not mentioned in the text.

## Extended-response question

1. Discuss the negative effects of unemployment on society and the economy.
   should also consider cases where unemployment may not be a concern in t

# Policy Conflicts – Inflation and Uner

*This case study requires knowledge of Section 4.2.3.4 – possible conflicts be objectives.*

Economies rarely seem to perform exactly the way we want them to. If a g problem, they often end up causing another in the process – a 'trade-off'. trade-offs that has been studied extensively is the conflict between inflatio William Phillips, a New-Zealand-born economist, proposed the short-run and unemployment in the 1950s that came to be known as the Phillips cur

Figure 1 plots UK inflation and unemployment from 1971–2000 (each dot

**Figure 1: UK inflation and unemployment 1971–2000**

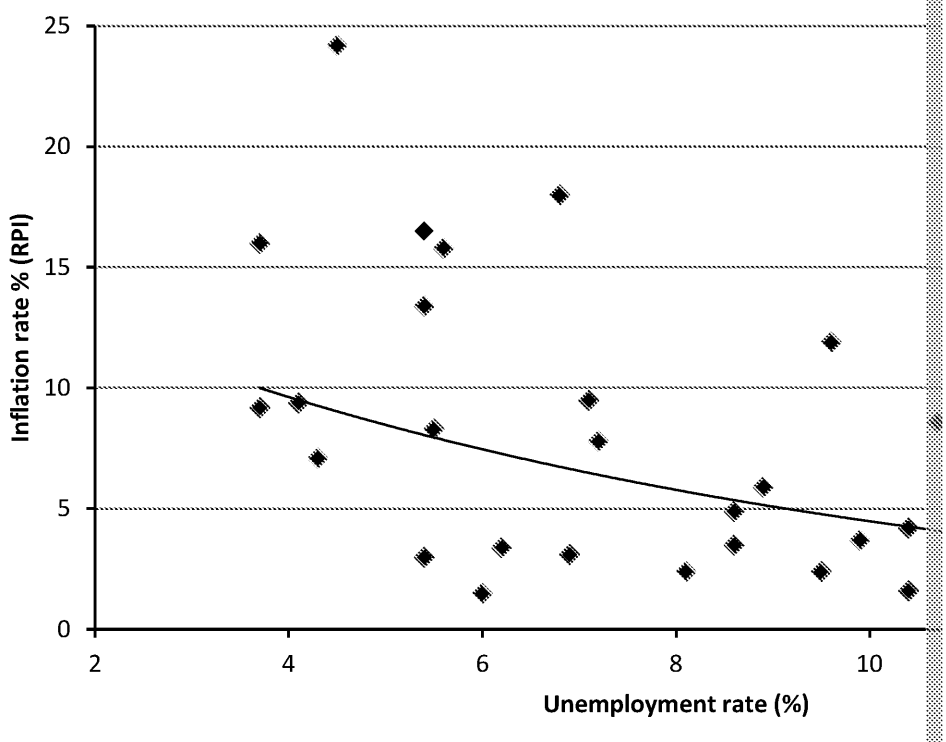
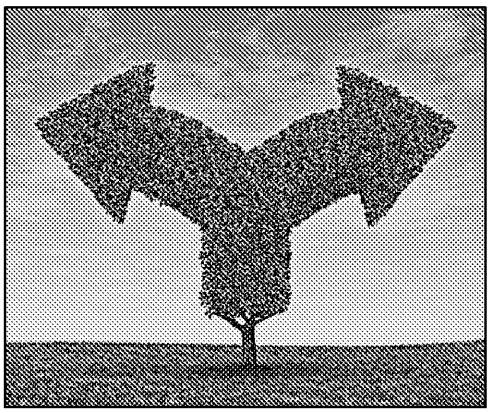


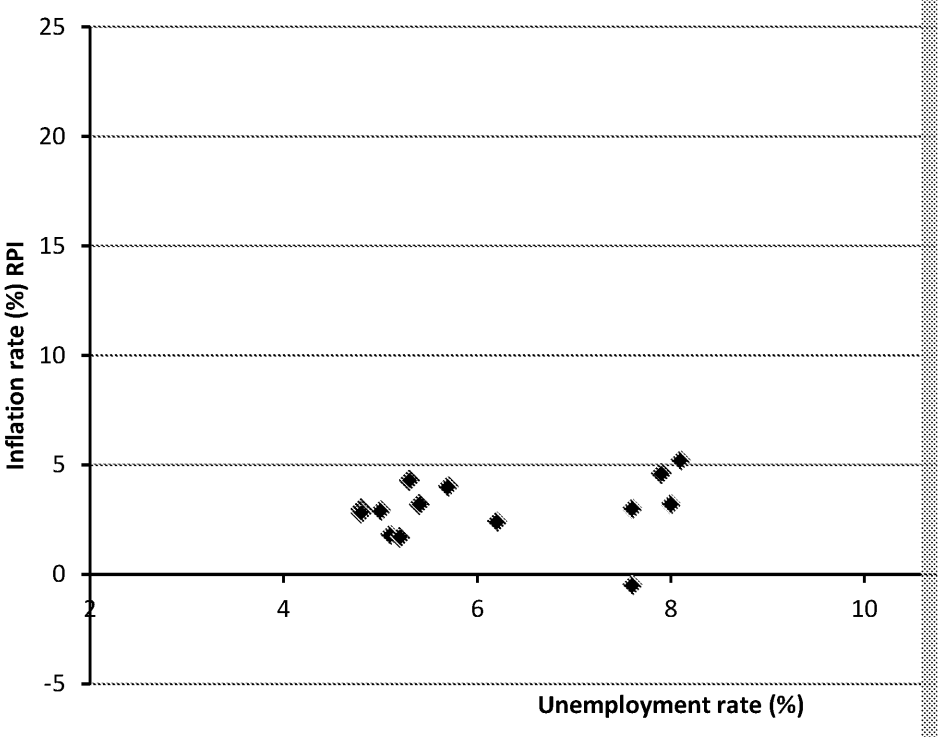

Figure 1 seems to show a rough pattern of the trade-off, although as with it is not nearly as neat as the theoretical Phillips Curve. Inflation is measu doesn't stretch back that far. Data is available for after 2000, but the relati (particularly due to the disruption caused by the financial crisis).



How do we explain this trend line? unemployment and high inflation. everyone in the labour force is emp higher wages to attract workers. T push). Furthermore, when wages a increase, pushing up demand for g pushes up the prices (demand-pull happens when unemployment is h

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 short-run 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.'* Discu

# Understanding Government B

*This case study requires knowledge of Section 4.2.4 – financial market*

Government bonds are staple products in the world of finance, and one of
government borrows money. Pension funds and private individuals often
as a safe way to generate returns over time (since governments rarely defa

In the UK, government bonds are called gilt-edged securities or 'gilts' (co
which means 'gold-coated'). Gilts have fixed 'maturity dates' (e.g. 5, 10 or
invested is to be paid back, while interest is paid periodically.

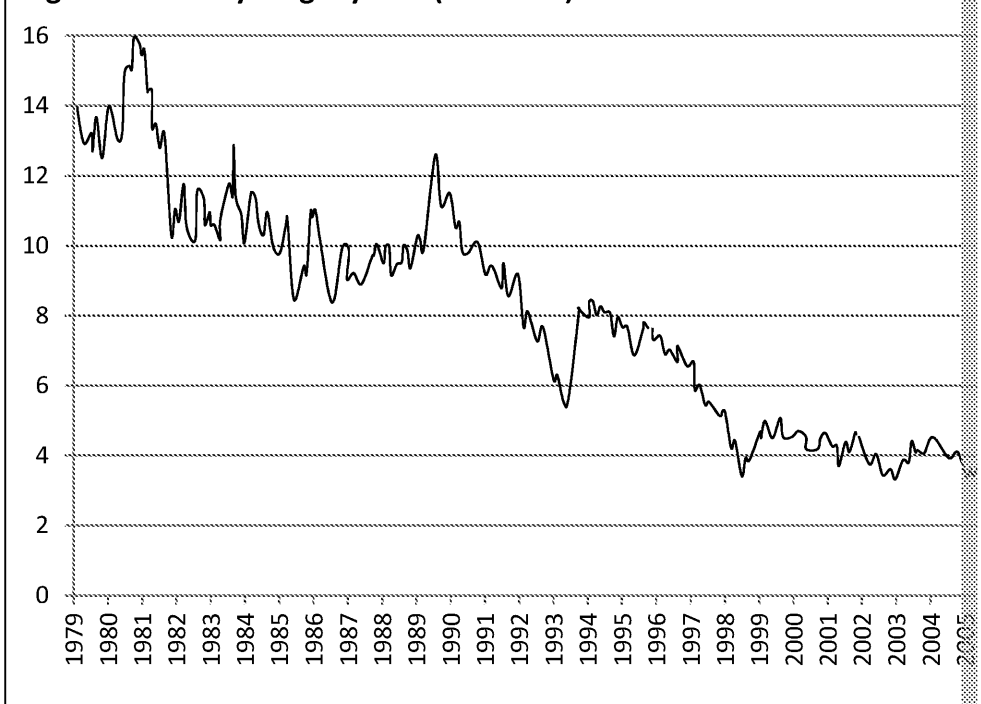
As an example, suppose you bought a 10-year gilt worth £1,000. Each bon
which is the annual rate of interest you get from the bond (the longer the m
higher the coupon rate). In the UK this is paid once every six months, so if
coupon rate then you would earn £25 every six months until the gilt matu

The coupon rate is determined by other interest rates in the market: there
5% coupon rate if there were plenty of other products offering a 10% retur
not account for inflation, so investors will have to consider whether this w
investment.

In the real world, government bonds are often traded between people befo
such, investors look at the 'yield' of a bond to determine its value. If mark
after buying your 5% bond, then your bond would be relatively valuable -
willing to buy it for £1,100 rather than the initial £1,000 you paid. In this ca
would go down: since the new owner is still only getting 5% of the origina
£1,100 they paid for it. Yield is calculated as the annual interest payment (
price of the bond (so buying it for £1,100 would mean that the yield is 50 /

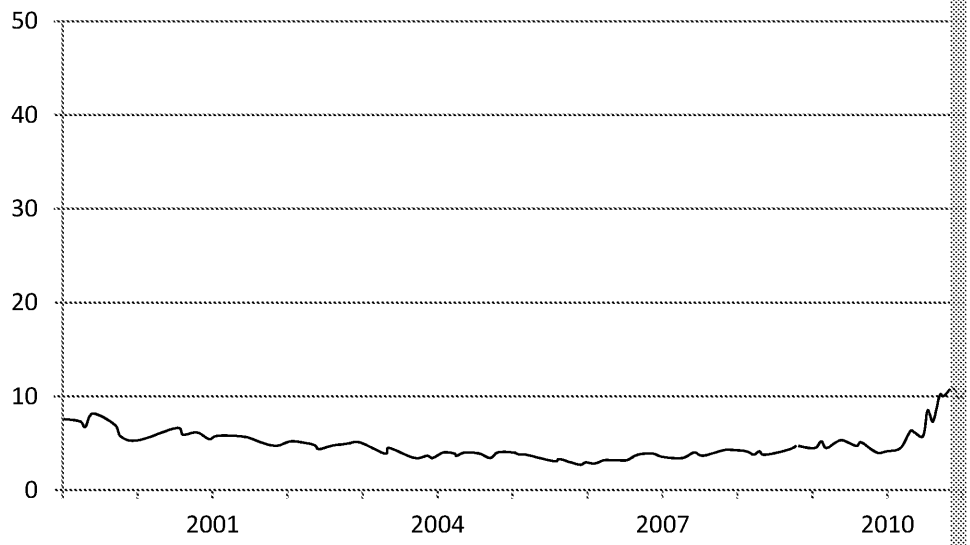
Figure 1 shows the change in 10-year gilt yields since 1981:

**Figure 1: UK 10-year gilt yields (annual %)**



Yields are at historic lows at the moment: one reason is that oil and food p
inflation (and low inflation makes the real value of existing bonds more va
and pushing down yields). Another reason is that yields for German Bunc
even lower, which has increased the demand for gilts. This is good news
it can borrow money relatively cheaply.

**Figure 2: Greek 10-year government bond yields (annual %)**




## Use the data

1. (a) Describe the trend in Greek government bond yields since 2008.
   (b) Explain why the yields on Greek bonds are consistently higher than the

## Test your knowledge

1. (a) The passage states that demand for gilts has increased, since German B
   Explain why an increasing demand for gilts reduces the yield of gilts.
   (b) Suppose a £1,000 30-year government bond has an annual coupon rate
   falls to £850, calculate the yield of this bond.

2. Explain the difference between commercial banks and investment banks.

## Extended-response question

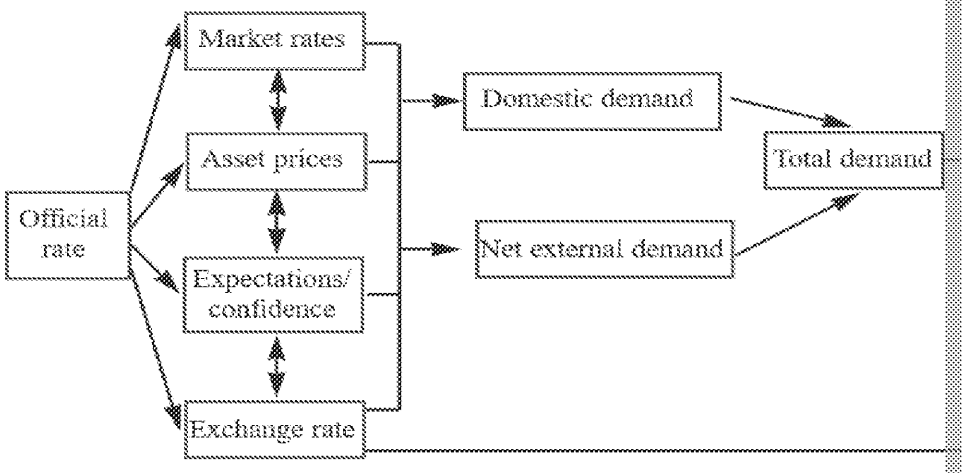
1. 'Low bond yields indicate that it is cheap for the government to borrow mo
   borrow more money to help stimulate the economy.' Explain why low bond
   the government to borrow money, and (in the context of the UK governmen
   borrowing as a result.

# Central Banking: the BOE and th

*This case study requires knowledge of Section 4.2.4 – financial market*

Central banks, along with the government, have a key role in managing ar
of monetary policy. The main policy instruments that central banks can us
supply and changing the interest rate (which affects the economy via the '
mechanism').

**Figure 1: Monetary policy transmission mechanism**




**The Bank of England**

The BoE became independent from the UK government in 1998. At that ti
consensus among economists that central banks should be independent, t
manipulating monetary policy for their own reasons (e.g. printing money

The Bank of England is tasked with maintaining financial stability in the e
currency and inflation at around 2%. Since March 2009, the base interest r
of 0.5%. Every three months, the BoE's Monetary Policy Committee (a gro
Bank) produces a report explaining their decision on interest rates. In the
decided to keep interest rates low in light of low inflation, and weak pros

Given the persistence of low inflation and relatively weak demand in the
increasingly to the money supply as a means of expanding the economy. T
money supply simply by adjusting the amount of coins and banknotes in
financial crisis 'quantitative easing' has become more prevalent. This invo
in the hope that this increases the availability of credit for businesses and

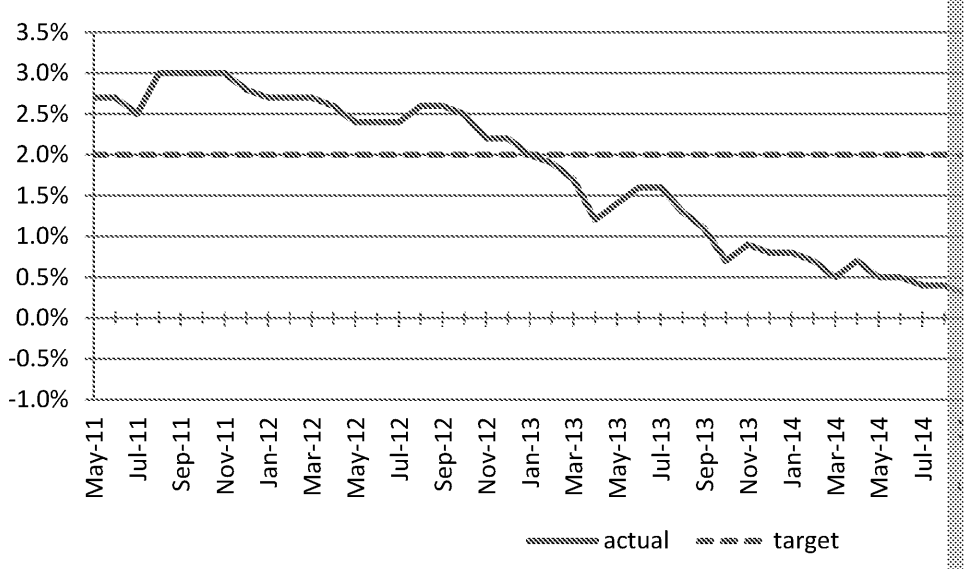
Watch this short video for a fuller explanation of QE:
***http://www.bankofengland.co.uk/monetarypolicy/pages/qe/default.aspx***

**The European Central Bank (ECB)**

The ECB, created in 1998, is the central bank that manages the eurozone e
maintaining price stability, and aims to keep inflation just below 2% (simi

Recently, inflation has been very low in the eurozone, despite the very lo
The ECB has repeatedly tried to kick-start growth via increasing the mone
purchasing (or quantitative easing), but inflation is yet to respond noticea

**Figure 2: euro area monthly inflation (annual rate)**




Source: ECB Statistics. Inflation measure is the HICP (Harmonised Index of Consumers Prices). This
CPI, but

With the continued weakness of the eurozone, the idea of using 'helicopte
this is basically the central bank giving away money for free, perhaps thro
is the same idea as quantitative easing, but it bypasses banks and other fir
money going straight to households. This should increase consumer spen
would be a highly controversial policy. Others have argued that there is o
do on its own to stimulate an economy, and that there is a greater need fo
weak economies.

## Use the data

1. Look at the monetary policy transmission mechanism diagram.
   (a) Explain how the official interest rate affects the exchange rate.
   (b) Explain how the exchange rate affects import prices.
   (c) Explain how import prices affect inflation.

## Test your knowledge

1. Using Figure 2:
   (a) Identify a period of deflation
   (b) Identify a period of disinflation
   (c) Which of the following sets of price indexes correctly describes the infl

| Price Index | Feb-12 | Feb-13 | F |
|---|---|---|---|
| A | 100 | 98.7 | |
| B | 100 | 102.3 | |
| C | 100 | 101.9 | |
| D | 100 | 101.6 | |

## Extended-response question

1. Discuss the extent to which a central bank alone can help to lift an economy

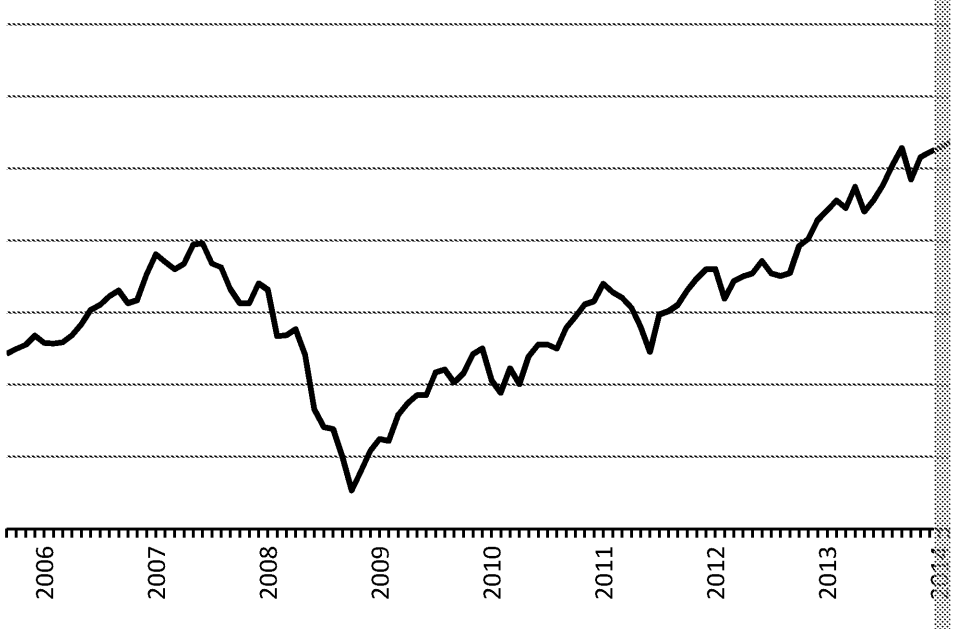
# Market Failure in the Financial

*This case study requires knowledge of Section 4.2.4 – financial market*

The Global Financial Crisis of 2008 is a rich opportunity for study in economics, particularly when it comes to the financial sector. Michael Lewis's book on the subject, *The Big Short*, was adapted into a film in 2016 – a rare case where an economic issue becomes a mainstream hit!

As we know, the global economy experienced a massive downturn in the closing months of 2008. Figure 1 shows the precipitous fall in the Dow Jones Industrial Average, an indicator of the health of the US stock market (and the world economy in general).

**Figure 1: Dow Jones Industrial Average (2006–2016)**




So, what were the specific market failures that led to this crash? Arguably had its roots in asymmetric information (although some may call it reckles exuberance'). In the US, the early 2000s were years of unparalleled prospe financial system was high. As such, some banks began extending mortga homeowners who were considered 'sub-prime' (that is, unlikely to pay it l

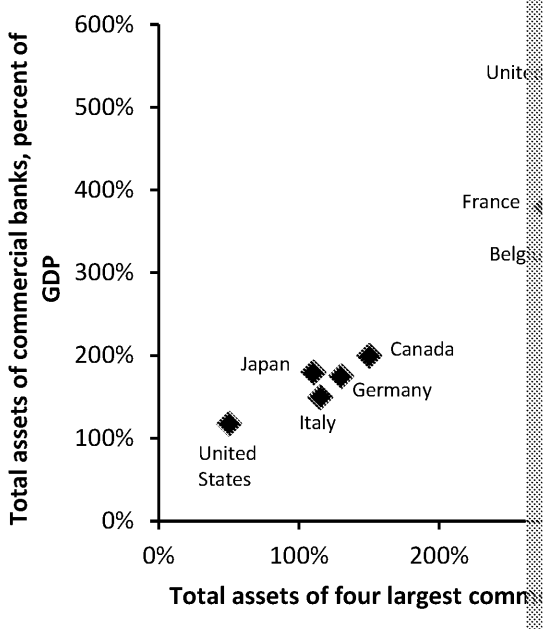
Extending these risky loans was encouraged by the development of variou such as 'credit default swaps' (CDSs) and 'collateralised debt obligations' of risk between different parties. The problem with these products was th them understood what they really meant, or how risky they actually were information comes in). As such, when the credit bubble burst, banks and much they actually stood to lose (this is where terms such as 'toxic assets' triggering a panic and the ensuing financial meltdown.

The crisis was also characterised by excessive speculation, and the creatio (particularly in housing). Almost all banks were very highly 'leveraged' (

loans far exceeded the value of their reserve funds), so an unexpected dec
was devastating. Since the crash, the rules on the amount of reserves bank
tightened up.

Another aspect of market failure that came in after the crisis is moral haza
out the failing banks because they hoped that it would prevent even more
event of the banks going under. If true free-market economics had prevai
excessive risks would simply have failed. But since they were bailed out,
continue taking risks in the future (knowing that they will probably be ba
example of moral hazard.

**Figure 2**




Source:
See: https://www.treasury.gov/resource-center/data-chart-center/Doc

All the market failures mentioned so far are unfortunate, but legal. In some cases, markets were illegally rigged to gain some advantage. The most notorious case of this was in the UK with the Libor rigging scandal. Libor is the London Inter-Bank Offered Rate (a benchmark rate for lending between financial institutions). When the financial crisis started, the Libor rate increased (since it was deemed riskier to lend between banks). Some bankers lied about the rates at which they could borrow, effectively rigging the rate to be more favour
another distortion in the market, exacerbating future losses.

Hopefully economists and policymakers can learn from this episode in wo
severe crises from occurring again.

## Use the data

1. Does Figure 2 suggest that the UK was more or less exposed to a financial cr
2. Estimate how much the Dow Jones Industrial Average declined from its pea
point.
3. Do you think governments should regulate financial institutions more or les
reasons for your answer.

## Test your knowledge…

1. Name two basic functions of the financial market.
2. State one other type of market failure not mentioned in the passage, and h
financial crisis.

## Extended-response question

1. Examine the role of the central bank in the UK financial sector.

# Canada's Economic Policie

*This case study requires knowledge of Section 4.2.5.1 – fis*

One of the basic questions in macroeconomics is: how can a government b
Justin Trudeau, the Canadian Prime Minister elected in 2015, the answer i
spending, funded by a temporary budget deficit.

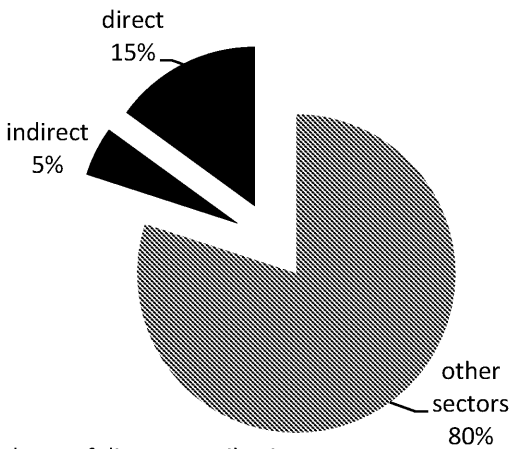
| Quick facts | Canada |
|---|---|
| **Population:** | 35 million |
| **Area:** | 9,984,670 km² (Second largest in the world) |
| **GDP per capita (nominal):** | $50,000 |
| **Government debt (% GDP), 2014:** | 86.5 |

The rationale for infrastructure spending is that it increases aggregate den
the short term (as the government pays the wages of new employees) and
boosts aggregate supply in the long term (as the economy works more
efficiently). Trudeau hopes to benefit from low interest rates to fund a $60
(Canadian dollars) spending plan over 10 years, channelled into areas incl
public transport, green projects and affordable housing ('social infrastruct
Around 30–35% of this spending is expected to return to the government v
higher tax revenues, as the spending induces more economic activity.

Despite a persistent budget deficit, all three main political parties (Liberal,
Democratic) support higher infrastructure spending, perhaps due to evide
depreciation have been mounting over time (leading to a so-called ' infras
Nevertheless, there are concerns over Canada's economic future due to th
such a low. Canada relies heavily on energy exports, as Figure 1 shows:

**Figure 1:**

**Contribution of natural resources to Nominal GDP (%), 2014**




Breakdown of direct contributions:
10% = Energy
4% = Minerals and Metals
1% = Forestry

**Contribution of natural**

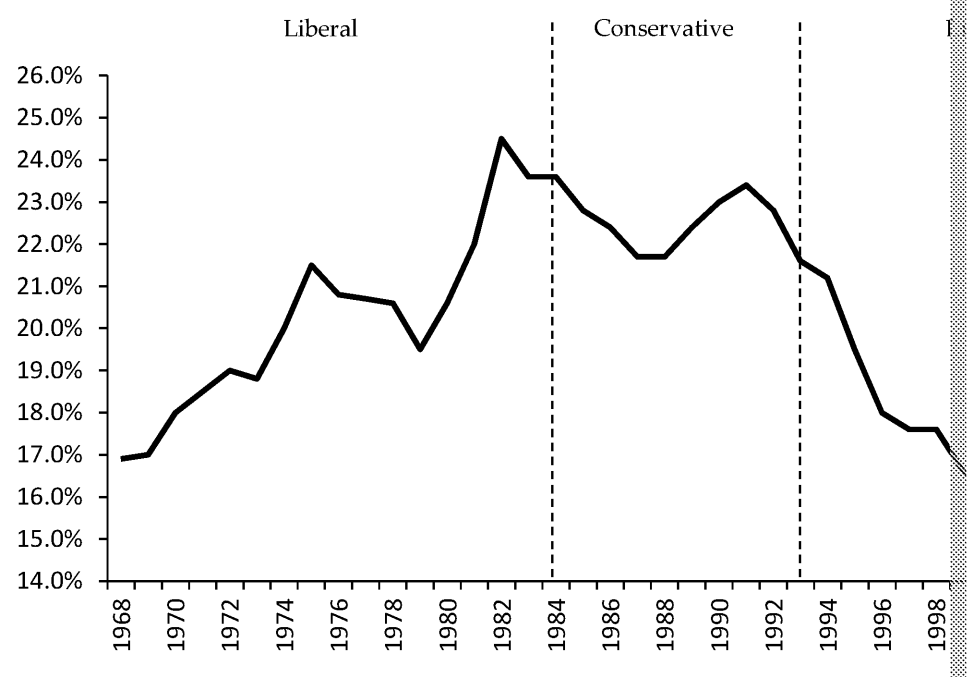
indir
900,0

Breakdown of direct contr
300,000 = Energy
400,000 = Minerals and M
200,000 = Forestry

Source: Natural Resources Canada estimates (July

Figure 2 shows the pattern of government spending as a share of total GD
where different governments (Liberal or Conservative) had control. As of
changed back to Liberal.

**Figure 2: public spending as a share of GDP by government**




It's interesting to note that the idea that left-of-centre governments (liberal
spending and right-of-centre governments (conservative) decrease govern
to hold. This same pattern can also be observed in the US. One explanatio
force government's hands: during the financial crisis of 2008, for example,
Minister Stephen Harper was forced to increase spending, possibly agains
graph after 2008 could also be explained by the effects of the recession, wh
graph shows public spending as a percentage of GDP, not total public spe

## Use the data

*Using the data in the article (quick facts, Figure 1, Figure 2)*:

1. Calculate the (nominal) size of Canada's government debt in $s.
2. Calculate (in $s) the contribution of energy to Canada's nominal GDP.
3. Calculate the percentage of Canadians that are in employment.
4. Estimate the proportion of GDP consisting of government spending in 2000.

## Test your knowledge…

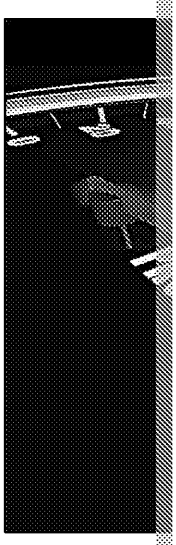
1. Look at the trend shown in Figure 2. What would you expect to happen to t
infrastructure plan described in the passage goes ahead?
2. Based on the information in the passage, show the effect of an increase in i
AD/AS diagram.

## Extended-response question

1. Discuss the possible effects of a large infrastructure spending project on the
and the long term.

# Productivity – the Key to Long-run

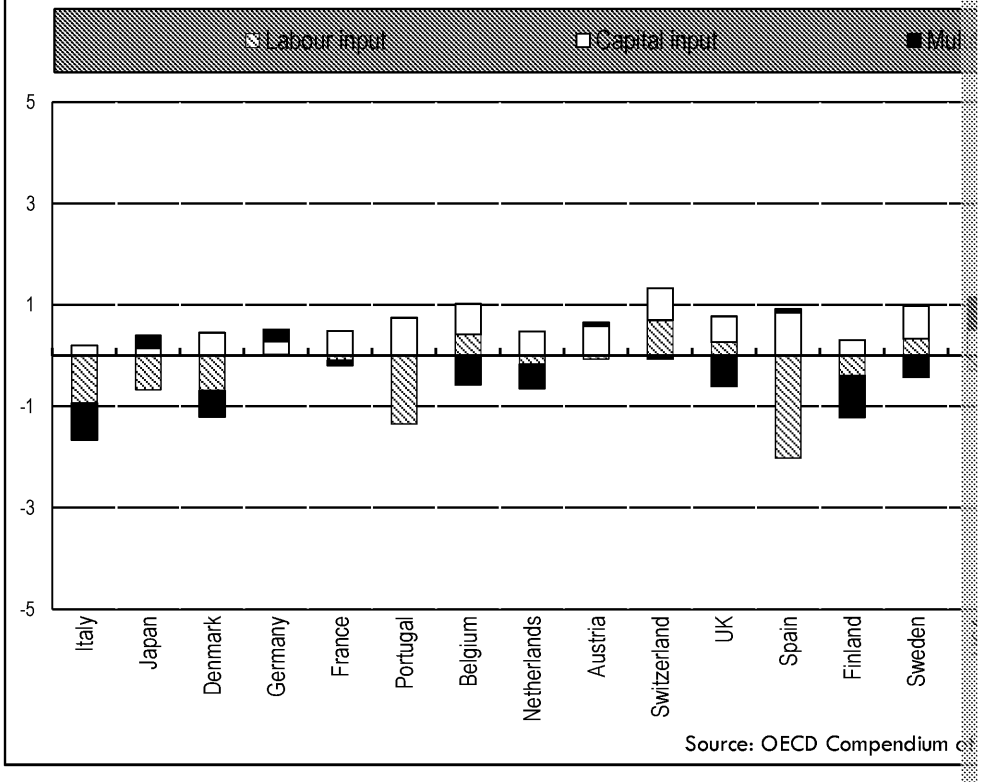
*This case study requires knowledge of Section 4.2.5.2 – suppl*



Most economists agree that in order to sustain economic growth in the long run, the supply-side of the economy must grow. For example, a government could try to increase the productive capacity of an economy by relaxing restrictions on the creation of new businesses, or investing in large infrastructure projects. Businesses have financial incentives to improve their own methods of working, perhaps by investing in capital or funding research into new technology – this should also contribute to the aggregate supply of an economy over time.

Considerable effort has gone into documenting the causes of economic growth. Figure 1 shows how GDP growth can be decomposed into four categories for a range of OECD countries. The OECD (Organisation for Economic Co-operation and Deve of predominantly high-income countries.

**Figure 1: Contributions to GDP growth: Total economy, annual percen (2007–2013)**




Source: OECD Compendium o

In Figure 1, labour input refers to the quantity of labour used in the econo and non-IT) also refers to the quantity used. Multifactor productivity refe resources are being used.

Figure 1 looks quite different when repeated for the period 2001–2007 (pre
when the world economy was performing well, almost all countries show
from all three sources (labour input, capital input and multifactor product

Historically, industrialisation is seen as a major catalyst for productivity g
Revolution is considered one of the primary reasons for the economic asce
1 in Case Study 1). This is why some models of economic development (s
great value on having a strong, urban economic hub in an economy.

Increasing productivity nowadays may be achieved by improving human
technology, privatising state-owned industries or benefiting from econom
idea of the division of labour (originally from Adam Smith).

Some economists are concerned that overall productivity growth has been
despite strong growth in the manufacturing sector (in the UK, it's estimate
the production of transport equipment such as cars and planes increased b
productivity is so important for long-run growth, it should certainly be m
coming years.

## Use the data

1. *Using the data in Figure 1*:
   (a) Which country gained most from increased capital input?
   (b) Which country suffered the worst loss in multifactor productivity?
   (c) Which of the three factors has contributed most to GDP growth on ave
   (d) By roughly how much did Spain's GDP decrease as a result of decreased
   (e) What was Ireland's annual GDP growth rate, according to these figures
2. Can you think of a link between Spain's loss of GDP due to a decrease in lab
   macroeconomic objectives?

## Test your knowledge…

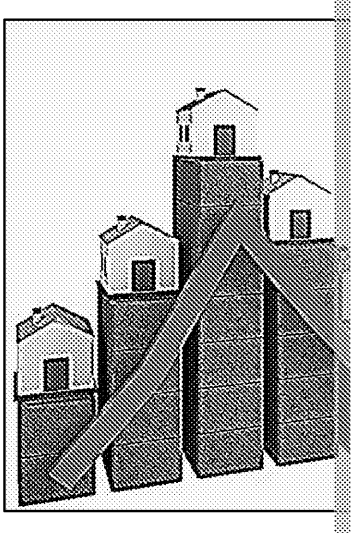
1. Show the likely effect of a large decrease in education spending on a classic
2. Aside from productivity and education, state two factors that influence long

## Extended-response question

1. Discuss the costs and benefits of a government policy to increase productivi
   investing in better education.

# Ireland's Housing Market Bul

*This case study requires knowledge of Section 4.2.5 – fiscal policy an*



One of the casualties of the 2008 financial crisis was Ireland's economy. Ireland has subsequently been dubbed one of the 'PIIGS' – economies which proved particularly unstable after the crisis, although compared to the rest of the countries (Portugal, Italy, Spain, Greece), it seems to have been recovering very strongly as of 2015.

As well as 'irrational exuberance' in financial markets, much of the blame for Ireland's economic crash can be traced back to different types of macroeconomic mismanagement.

> ***Irrational exuberance:***
> *This is a term originating from Alan Greenspan, ex-Chairman of the Federal Reserve (the central bank of the USA). It is used to describe the risky behaviour in the financial sector in the run-up to the crash.*

Prior to the crash, the world econo
rich opportunities for Irish banks t
low rates (particularly following Ir
There was very heavy investment
because this sector had never crash
confidence would prove to be misp
of investing, that investors should
range of assets, seems to have beer

In terms of the fiscal policy, the government adopted a 'pro-cyclical' appro
increased their spending in the boom period, as well as cutting taxes to att
proportion of these taxes were linked to the property sector). This left the
vulnerable to a bursting of the property sector bubble, in spite of warning
OECD. Ultimately, this meant that the government had next to no breathi
fiscal policy when the crisis hit.

Furthermore, regulators of the banking industry seem to have failed to pic
warning signs of an impending crash. This is particularly noteworthy sinc
was not nearly as complex or opaque as some other advanced economies (
extremely complicated financial products or 'derivatives' was flourishing)
systems also seem to have failed, permitting a very risky and unstable fina

Figures 1 and 2 show two historical measures of the housing market in Ire
is very evident in both.

**Figure 1: house prices against average income (long-term average = 10**

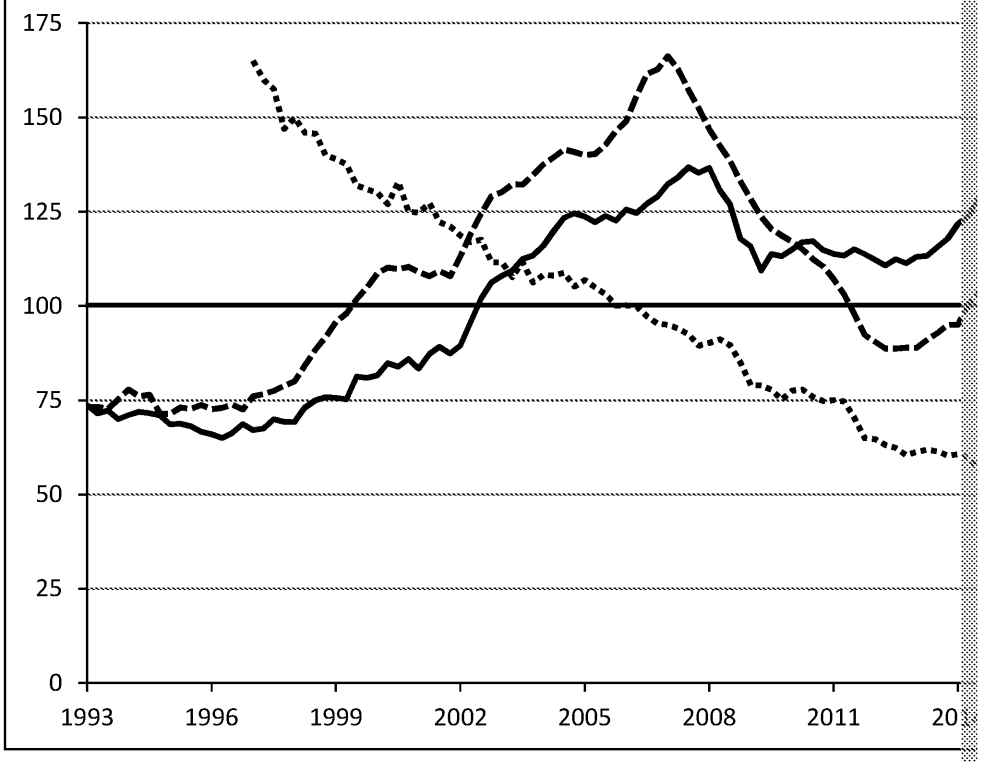
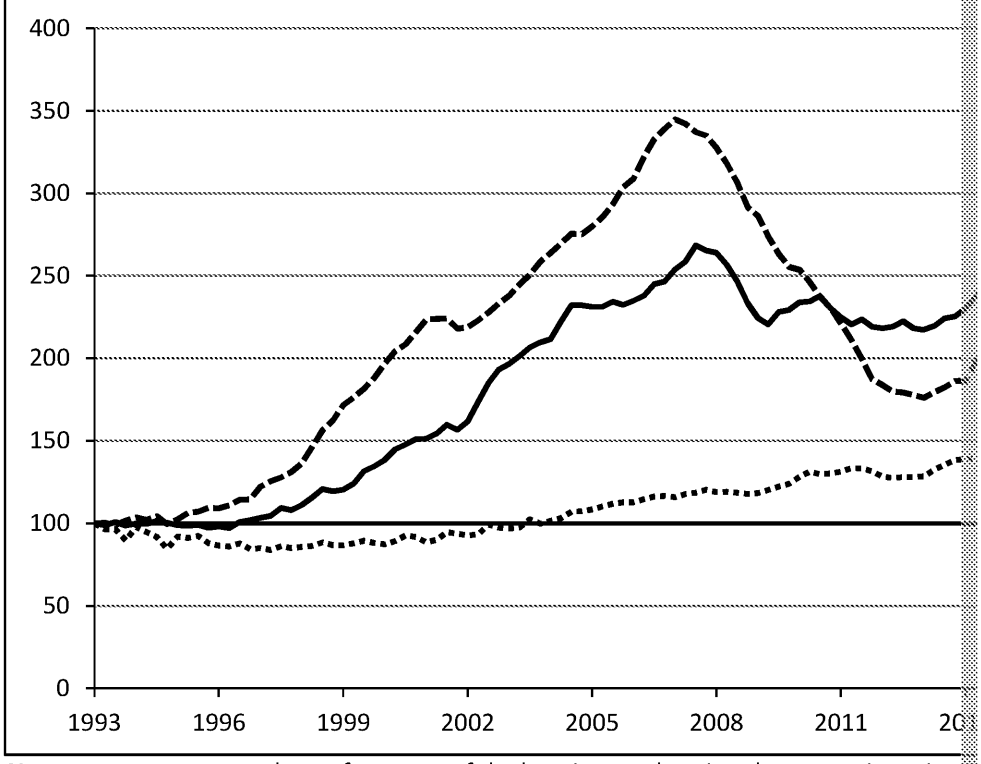



**Figure 2: prices in real terms (base year = 1993)**




***Note**: you can compare the performance of the housing markets in other countries using http://www.economist.com/blogs/dailychart/2011/11/global-house-prices*

Fortunately, it seems that Ireland's economy is on its feet again. Hopefull
experience will prevent such disastrous financial crises from occurring ag

## Use the data

1. Look at Figure 1. Suppose the long-term average house price in Ireland is al
income. If average income is €30,000, what would be the (average) price of
   (a) Q4 1980
   (b) Q1 2007

2. Look at Figure 2. In Q1 2007, compared to Ireland, were real house prices ir
(c) unable to be compared?

3. Looking at both graphs, can you think of a reason why China's house prices
fallen so consistently?

## Test your knowledge…

1. (a) Looking at Figure 2, describe the trend in house prices in Ireland over t
   (b) How many times greater were prices in Ireland in Q1 2007 than Q1 19

2. Explain whether Ireland's fiscal policy measures described in the extract wo
or a budget deficit in the short term.

## Extended-response question

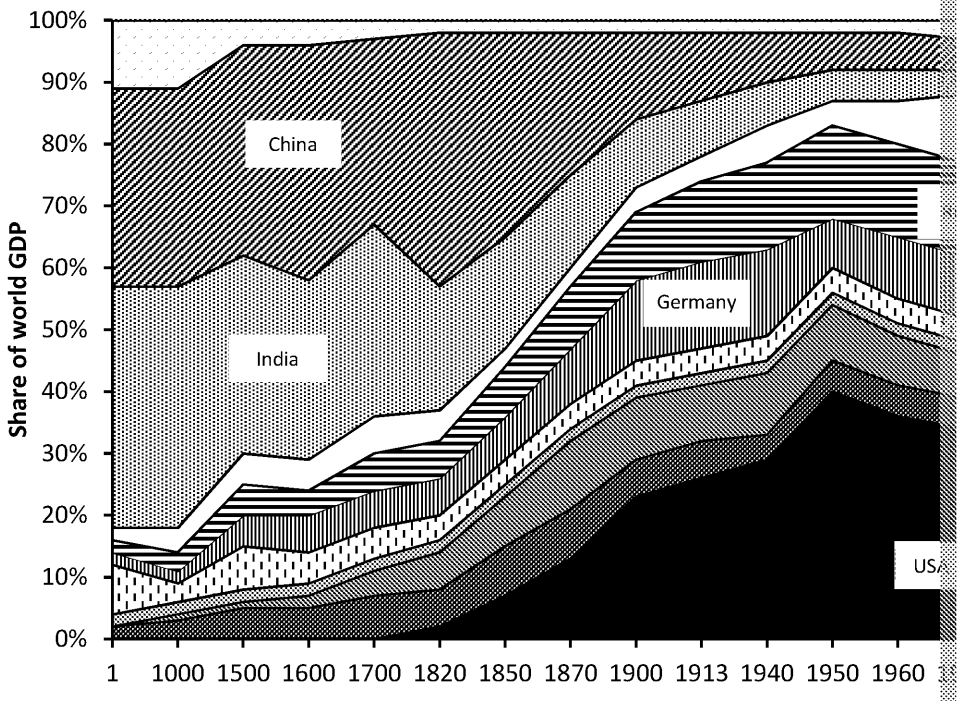
1. One of the key features of Ireland's economic boom (and subsequent bust)
Using an AD/AS diagram, discuss the effectiveness of deregulation as a supp
*(Note: your answer does not need to include any knowledge of different type*

# World Economic Superpowers: is the USA

*This case study requires knowledge of Section 4.2.6 – the international econom*
*income data.*

The twentieth and twenty-first centuries saw the United States of America
economic superpower of the world. Prior to the Industrial Revolution, the
China and India that held this honour.

**Figure 1: Economic history of China and other major powers**



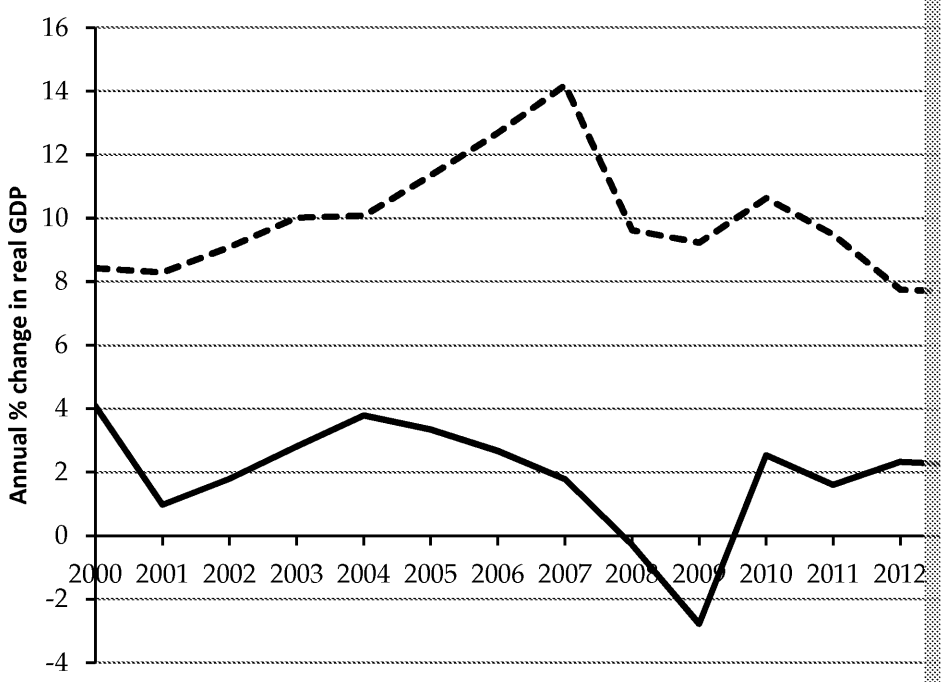

Some commentators reckon that the Chinese government are determined
title. Given the astonishing GDP growth rates recorded in China over rec
reality in the not too distant future.

China has experienced breakneck growth rates since the introduction of m
following the collapse of communism under Chairman Mao. China's gro
levels of investment and saving, and huge volumes of international trade.
economy to exploit its comparatively low unit labour costs, enhancing int
(although, it seems now that wages in China are finally starting to rise, as
labour dries up). More recently Chinese companies have been branching
markets (particularly LEDCs, but also in the UK, such as the 2015 investm
power industry).

Unlike most large modern economies, China does not have a pure floating
exchange rate for its currency (the renminbi). Exchange rates were fixed
against the US dollar from 1994 to 2005, but this gave way to a 'crawling p
system, whereby the government can adjust the exchange rate by small
amounts. This has led to periodic devaluations of the currency in an atten
to boost exports. This growth strategy in particular has proven controver
and some question the sustainability of China's growth in the long term.

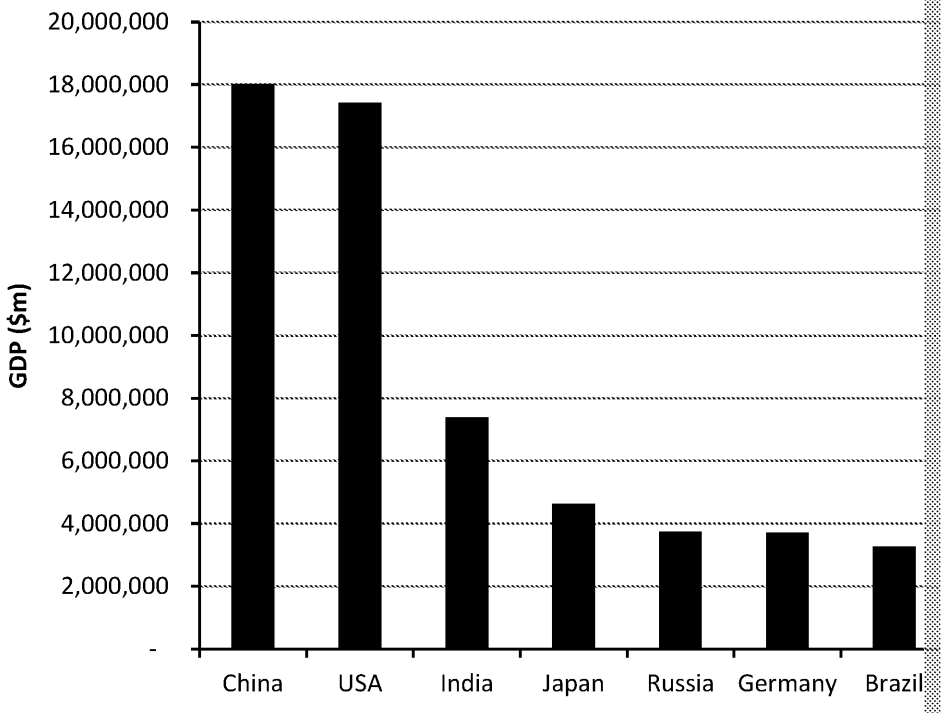
The US was hit hard by the 2008 financial crisis, as the banking system wa
international trade collapsed. This prompted a dramatic response by the U
confidence and liquidity to the markets. More recently, though, things ha
Federal Reserve felt confident enough to raise interest rates in December 2
2006. However, it seems unlikely that the US will be able to match China'
the foreseeable future.

**Figure 2: GDP Growth Rates 2000–2014**




In purchasing power parity (PPP) terms, China is already the world's larg
is notable that even though China still lags behind in per capita terms, eco
contributed more to the eradication of global poverty than just about any
few decades.

**Figure 3: PPP Adjusted GDP 2014**



## Use the data

1. Using Figure 1, roughly what share of world GDP did China make up in the fo
   (a) 1000
   (b) 1820
   (c) 1950
   (d) 2008

2. Looking at Figure 2:
   (a) Estimate the USA's GDP growth rate in 2010.
   (b) Estimate the China's GDP growth rate in 2010.
   (c) Suppose in 2010 USA's GDP was $15 trillion, and China's GDP was $6 tr
   calculated in (a) and (b), and assuming that both countries maintain the
   years (i.e. by 2025) which economy would be the largest?

## Test your knowledge…

1. (a) Define GDP per capita.
   (b) Explain why the rankings for China and the USA in Figure 3 would chang

2. (a) Explain the concept of PPP.
   (b) Explain why the rankings for China and the USA in Figure 3 would chan
   adjusted.

3. Based on the article, state three policies that have contributed to China's ec

## Extended-response question

1. *'Once population size and living costs are accounted for, GDP is a good mea
   economy is.'* Evaluate this claim.

# Brexit and Trading Blocs

*This case study requires knowledge of Section 4.2.6.2 -*
*Note: this was written before the EU referendum in Jur*

Trading blocs are an important feature of the modern world economy. So
today include:

- ASEAN (Association of South East Asian Nations).
- APEC (Asia-Pacific Economic Cooperation forum – has some cross-ov
- NAFTA (North American Free Trade Agreement – consisting of the U
- And, largest of all, the EU (European Union – currently at 28 member
  monetary union – the Eurozone).

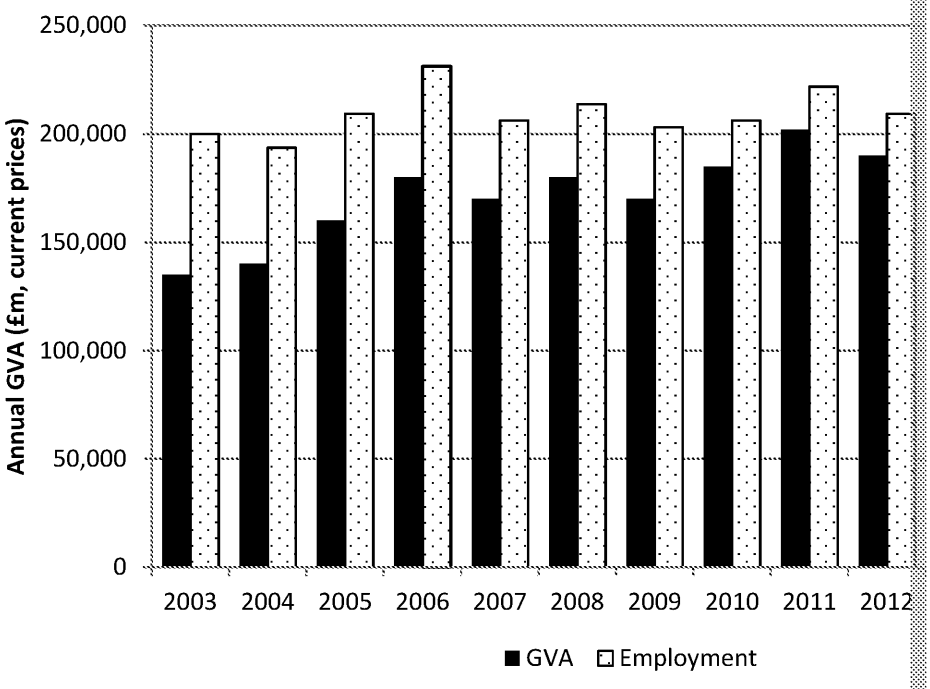
The basic idea of a trading bloc is to reduce trade barriers between partici
members to benefit from free trade. In 2016, the UK faced the important r
whether to stay in or leave the EU ('Brexit').

Supporters of Brexit (often called Eurosceptics), argued that leaving the EU
costs and free UK businesses from unnecessary regulations. Crucially, the
able to retain its trade links with Europe, and possibly improve their trade
world. There are also a number of non-economic reasons why they are in
relating to retaining greater control of the legal system and migration.

On the other hand, supporters of the 'Remain' campaign (pro-EU), particu
international links, argue that the UK would lose out on trade with the res
single market allows greater potential for economies of scale and lowers b
Furthermore, intra-EU financial transactions are less costly, and the harmo
increases trade and protects consumers.

The impact on the UK of being part of the EU has been researched extensi
of the positive economic effects in terms of employment and GVA (gross v
added is a similar measure to GDP.

**Figure 1: Contribution of UK exports (to the EU) to the UK economy (GV**



The 2014 estimate of GVA indicates that the EU export market, at around £187 billion, accounts for about 10% of UK GDP. Similarly, over three million jobs are linked to the EU (around 10% of the total). The EU is the UK's largest export market (around 45% of total exports), and the UK also receives just over 50% of its imports from the EU. It is undeniable, therefore, that the presence of the EU is vitally important to the UK economy.


However, these findings must be interpreted carefully: they do not account for the fact that the UK would still trade with the EU even if it weren't part of the assume that all of these benefits would be lost when we left the EU. Perhaps we with the EU member states from outside of the trading bloc, since these countrie (arguably) share many of our cultural values.

Analysing the likely effect of Brexit on the UK economy is much trickier than anal membership, because there are so many more uncertain factors. It could depen manages to leave, for example. Indeed, the uncertainty over what would happe argument put forward by EU supporters.

It is generally agreed that the UK's decision to stay out of a union was a wise mo the Eurozone during the financial crisis. It is less clear whether Brexit will be for there are so many competing political interests at stake as well as economic inte

## Use the data

1. From the passage, identify one economic argument in favour of staying in t argument in favour of leaving the EU.
2. Describe the trend in employment since 2011 shown in Figure 1, and give o

## Test your knowledge…

1. Define the term 'customs union'.
2. The economic benefits of free-trade areas are fairly clear. What about the di

## Extended-response question

1. With reference to the Eurozone, discuss the costs and benefits of monetary

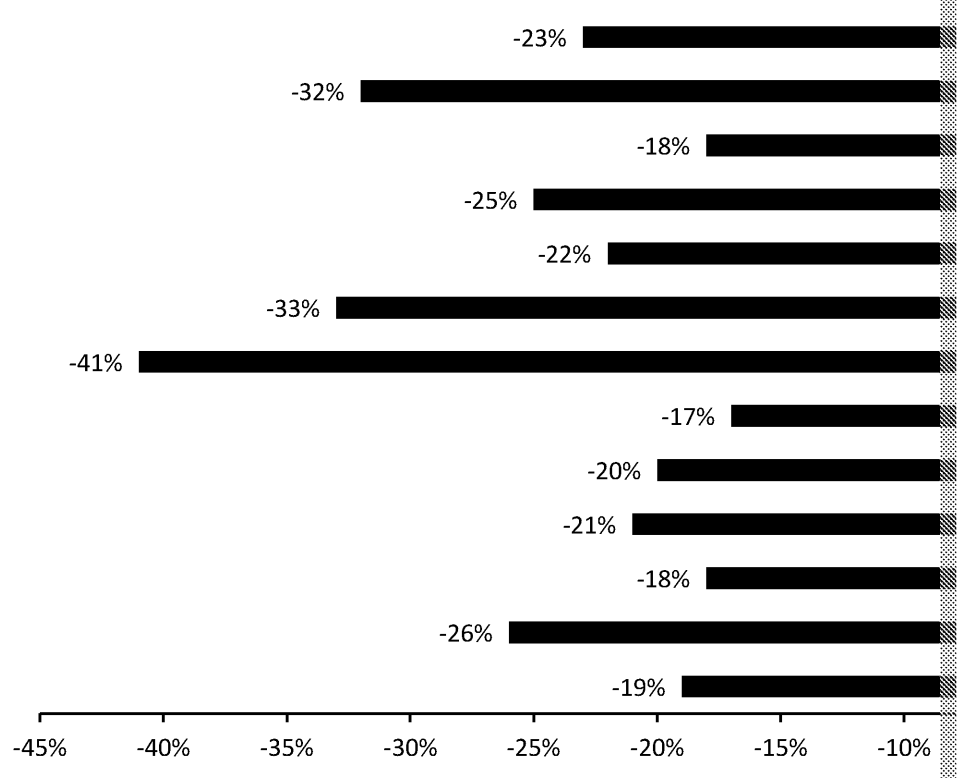
# Subtle Protectionism

*This case study requires knowledge of Section 4.2.6.2 – trade and 4.2.6.3*

To what extent is protectionism a thing of the past? With the rise of huge international trading blocs, it seems that use of standard protectionist instruments such as tariffs, quotas, domestic subsidies, etc. has dwindled over time.


After the Great Depression of 1929, one of the key barriers to growth was the rise of protectionism, as governments scrambled to defend domestic employment, or retaliate against foreign protectionism. It is estimated that protectionist policies contributed to 25% of the trade collapse in the US after the Great Depression. After the Financial Crisis of 2008, protectionism also rose (e.g. tariffs by Russia, subsidies for domestic car manufacturers in several countries), but to a lesser extent. This is partially due to the influence of the WTO, but also due to a more general acceptance of the virtues of free trade.

**Figure 1: Collapse of trade in the financial crisis (selected countries)**

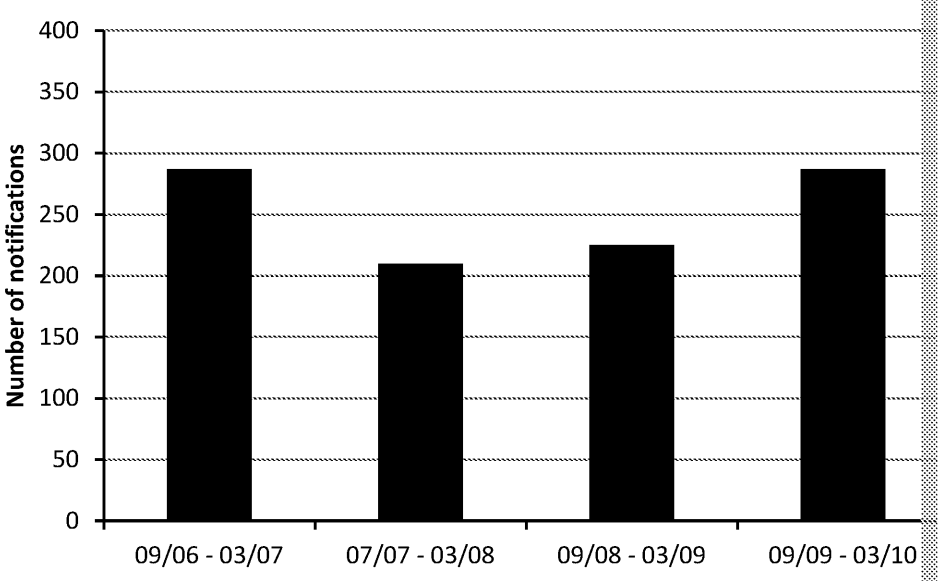



Source: CEPR. 'The collapse of global trade, murky protectionism, and

However, there has been a notable rise in more subtle, 'murky' types of pr
barriers) in a wide range of countries, most notably in Russia. These meas
quantify, and less obviously protectionist. Examples of these measures in

- Stricter licensing requirements for imports (Argentina)
- Higher standards for import products (e.g. China – see Figure 2)
- Only allowing certain goods through certain ports (Indonesia)
- Anti-dumping (USA – this is a charge on imports of goods that are be
  low)
- Bailouts of sectors such as banking (e.g. UK). The initial objective of p
  to the economy may have been replaced by the incentive to stimulate
- Industrial policies that effectively amount to export subsidies. (Brazil
  that fit this description: such as requiring foreign-owned car manufac
  meet tough efficiency standards and innovation targets.)
- Various types of export restrictions

**Figure 2 – SPS notifications by G20 economies (2006–11)**




*Note SPS stands for 'sanitary and phytosanitary measures' – the idea is to prevent unsafe go*

These covert types of protectionism are difficult for the WTO to police effe
many different guises. Their presence seems to suggest that the age of pro

## Use the data

1. Explain why a country may wish to restrict exports.
2. Explain why the trend in SPS notifications shown in Figure 2 might have occ

## Test your knowledge…

1. What is the difference between a quota and a tariff?
2. Suppose a country significantly increased protectionist trade measures. Exp
   country's current account balance in the short term and long term.
3. Illustrate the effect of a tariff using a diagram. Identify tariff revenue, dead
   of imports.

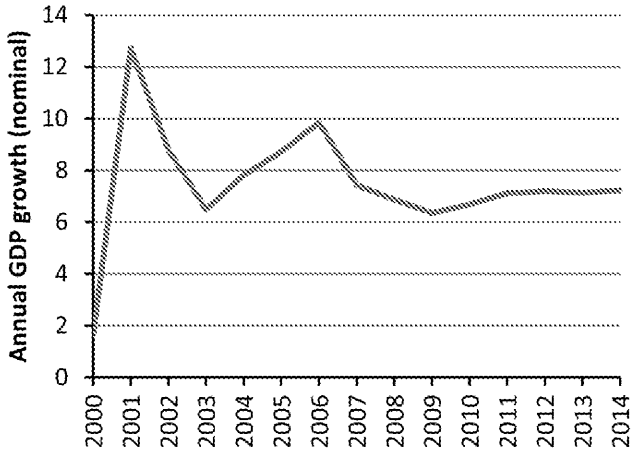
## Extended-response question

1. The UK imports and exports large numbers of cars. Discuss the effect on ag
   UK of imposing a tariff on imported cars.

# Mozambique – an African li

*This case study requires knowledge of Section 4.2.6.5 – economic gro*

**Figure 1: Mozambique's GDP growth 2000–2014**




*Figures are in constant 2005 US$*

Source: World Bank.

African economie
in the media – for
perception of Afri
under-developed
However, there a
number of Africa
footsteps of the A
economic growth
among these stell
Having shed its c
a 16-year civil wa
Mozambique's ec
impressive.

Mozambique's hu
(particularly coal and gas) have made it a vital trade partner for China an
to a strong currency (the metical) and high levels of foreign investment in

Having abundant natural resources does not always translate into econom
have suffered from the so-called 'resource curse', where excessive depend
harms economic growth. This could be because other industries are negle
captured via corruption. However, in the case of Mozambique, the benefi
endowments have been augmented by sound macroeconomic managemer
education spending and policies to promote competition. Mozambique n
business hubs, complete with shopping centres, restaurants and traffic jan

Despite all this, there are concerns that this surge in economic growth is n
development. Figure 2 shows the components of the HDI index for Moza
disappointing 180th out of 188:

**Figure 2**

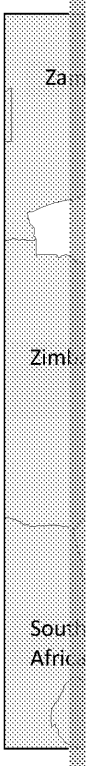
| Country | HDI value (2014) | HDI rank (out of 188) | Life expectancy at birth | Expected years of schooling | M |
|---|---|---|---|---|---|
| Mozambique | 0.416 | 180 | 55.1 | 9.3 | |
| India | 0.609 | 130 | 68 | 11.7 | |
| UK | 0.907 | 14 | 80.7 | 16.2 | |
| | | | Health dimension | Education dimen | |

*Note: 'Expected years of schooling' is for children entering school age, 'mean years of sch*

So

One of the big concerns is that poverty rates (one of the key dimensions of economic development) are still high, with over half of the 25 million people in poverty. If the gains from economic growth do not trickle down into all parts of society, Mozambique's success may be short-lived. African history is littered with examples of countries where corruption chokes off economic development.

Furthermore, as with many developing countries, there is a substantial gap in living standards between the urban and rural populations (the same is true of some countries that are a bit more developed, including China). Many researchers argue that improving agricultural productivity is one of the most important ways of closing this gap, since a very high proportion of the rural workers' income depends on agriculture.




## Use the data

1. Briefly compare Mozambique's GDP growth rate to the UK's.
2. Look at Figure 2, what does it mean to say that the living standards figures a
   (a) GNI (rather than GDP)?
   (b) per capita?
   (c) PPP?
3. In Figure 2, what does the difference between the mean years of schooling a schooling indicate about the progress of development in Mozambique?

## Test your knowledge…

1. State one other indicator of development, other than those included in the living standards).
2. Identify two causes of Mozambique's high economic growth.

## Extended-response question

1. Discuss the importance of having abundant natural resources for economic such as Mozambique.

## Mark scheme for extended-response questions

***10 marks***

| | | Knowledge (2), application (2) and analysis (2) |
|---|---|---|
| | 0 | No relevant answer given. |
| Level 1 | 1–2 | A few concepts and examples may be identified correctly, but may<br>Absence of thought behind the causes and effects. |
| Level 2 | 3–4 | Some knowledge of economic concepts is shown, partially linked t<br>reasoning skills, but may focus too much on one side of an argume |
| Level 3 | 5–6 | Knowledge of the economic concepts is accurate. Links to the que<br>examples. Analysis is well reasoned, 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<br>reasoning and evidence. |
| Level 2 | 3–4 | Accurate, balanced evaluative comments are made, supporting a r<br>directly to the question. |

***12 marks***

| | | Knowledge (2), application (2) and analysis (4) |
|---|---|---|
| | 0 | No relevant answer given. |
| Level 1 | 1–2 | A few concepts and examples may be identified correctly, but may<br>Absence of thought behind the causes and effects. |
| Level 2 | 3–5 | Some knowledge of economic concepts is shown, partially linked t<br>reasoning skills, but may focus too much on one side of an argume |
| Level 3 | 6–8 | Knowledge of the economic concepts is accurate. Links to the que<br>examples. Analysis is well reasoned, 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<br>reasoning and evidence. |
| Level 2 | 3–4 | Accurate, balanced evaluative comments are made, supporting a r<br>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<br>thought behind the causes and effects. |
| Level 2 | 4–6 | Some knowledge of economic concepts is shown, partially linked t<br>reasoning skills, but may focus too much on one side of an argume |
| Level 3 | 7–9 | Knowledge of the economic concepts is very accurate. Links to the<br>examples. Analysis is well reasoned and logical, and appropriate f |
| | | **Evaluation (6)** |
| | 0 | No evaluation. |
| Level 1 | 1–2 | Limited attempt at evaluation – may be only loosely related to the<br>reasoning. |
| Level 2 | 3–4 | Clear evidence of evaluative comments, though they may be unfai<br>argument. Reasoning / supporting evidence are provided may be |
| Level 3 | 5–6 | Accurate, balanced evaluative comments are made, supporting a r<br>directly to the question. |

*25 marks*

| | | Knowledge (4), application (4) and analysis (8) |
|---|---|---|
| | 0 | No relevant answer given. |
| Level 1 | 1–4 | A few concepts may be identified correctly, but inconsistently, and thought behind the causes and effects. |
| Level 2 | 5–8 | Some knowledge of economic concepts is shown, partially linked t incomplete or basic reasoning skills. |
| Level 3 | 9–12 | Good knowledge of the relevant economic concepts is displayed, l evidence to support the main arguments. Analysis is well develop side of an argument. |
| Level 4 | 13–16 | Knowledge of the economic concepts is very accurate. Links to the examples. Analysis is well reasoned and logical, and appropriate f |
| | | **Evaluation (6)** |
| | 0 | No evaluation. |
| Level 1 | 1–3 | Limited attempt at evaluation – may be only loosely related to the reasoning. |
| Level 2 | 4–6 | Clear evidence of evaluative comments, though they may be unfai argument. Reasoning / supporting evidence provided may be inco |
| Level 3 | 7–9 | Accurate, balanced evaluative comments are made, supporting a r directly to the question. |

## Case Study 1: Youth unemployment in Italy

*Use the data*

1. The 55–64 age group data shows a slight rise in the unemployment rate between 2 around 6%). The 15–24 age group also shows an increase, but a far more dramatic low of around 20% in 2007 to 40% by 2013.

2. (a) An increase of around 210,000 (accept 10,000 either way).
   (b) After a small increase in 1994, unemployment fell steadily until 2002. The nex percentage points, before falling to a low of 20% in 2007. The overall trend w

3. There are any number of possible solutions you could come up with, but virtually al drawback. Example policies and drawbacks you might come up with could include:
   - Investing in education and training – long-term solution only (has an opportun well (the article states that more young people are going to university, but the
   - Providing incentives/legislation to encourage employers to employ young peo politically).
   - Investing in existing/new industries to expand employment opportunities (onl guaranteed in these sectors, very long-term solution).
   - Taxing older workers, who benefit from employment protection, to fund sche (politically unpopular).

*Test your knowledge*

1. Unemployment rate = number of unemployed people / total labour force. (1)
   In this case, the total labour force has decreased, so the unemployment rate increa

2. The text already mentioned structural unemployment, so possible correct answers seasonal unemployment, demand deficiency / cyclical unemployment, unemploym involuntary/voluntary unemployment.

   1 mark for each identified cause.

*Extended-response question*

1. The answer should focus on both the economic and social consequences of unempl Social consequences include crime, health problems, lower living standards (leading problems, loss of skills, or any similar justified outcome.

   The main economic consequences include lower economic growth (since less is bei to the lower economic activity), and a worsening government budget deficit (since increase, and tax revenues fall). The passage also mentions the possibility of a brai

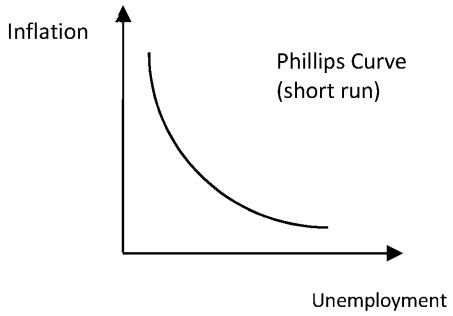
To get higher marks, these consequences (particularly the economic ones) must be
simply state them.

For evaluation points, it could be mentioned that some types of unemployment are
the long term, such as frictional unemployment (which is inherently temporary), se
temporary) and possibly cyclical unemployment (so long as the economic downturn
to note that in the case of Italy, where unemployment (and particularly youth unem
unemployment cannot be as easily ignored.

## Case Study 2: 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 3: Understanding government bonds

*Use the data*

1. (a) In 2008, Greek bonds yields were around 5%, but over the next few years the
peak of over 40% around 2012. Yields then fell steadily, dipping below 10% be
falling below 10% again at the end of 2015.
(Note: this is roughly the kind of detail expected for an exam answer, althoug
bit less.)

(b) The main reason why the yields on Greek bonds (particularly during the financ yields on gilts is because lending to the Greek government is considered to be government.

*Test your knowledge*

1. (a) If demand for gilts is high, then the price of gilts goes up (1). When the price o (Note: see the numerical example in passage if this is confusing!)
   (b) The yield is 70 / 850 * 100 = 8.2%. (1 mark for method, 1 mark for answer). Th the bond fell.

2. Broadly speaking, commercial banks focus on taking deposits and lending money (1 operate in all sorts of different areas of finance, such as buying and selling governm other investments, and helping companies with mergers and acquisitions. (1)

*Extended-response question*

1. Your answer should first explain the link between bond yields and government bor a bond is not the same as the coupon rate! If bond yields are low, this means that t market must be high. If prices of existing bonds are high, then market interest rates have a higher interest rate than new ones). Falling market interest rates means tha cheaply: they won't have to pay out very much once the bond matures.

   As for whether this means that the government should increase its borrowing level would be given more information to go on before answering a question such as this of some general points:
   - It depends on how high current levels of borrowing are. If the government alr national debt, it might be considered unwise to increase borrowing even if int cost of repaying the national debt will probably go up (after all, if the governm number of bonds it issues, the cost of borrowing is likely to rise).
   - It depends on the growth rate of the economy. If the economy is growing rapi without worsening the national debt as a proportion of GDP. Gains from econ higher costs of servicing the debt.
   - If the economy is in a deep recession, then it might be sensible to increase bo levels of government spending to stimulate the economy. The success of this it is coordinated with monetary policy, whether there is an appropriate destin whether there is confidence in the government's ability to keep borrowing. In borrowing costs went up sharply when markets realised that the Greek gover (see Figure 2).

## Case Study 4: Central banking: the BoE and the ECB

*Use the data*

1. (a) When the official interest rate in the UK goes up, it makes it more attractive fo pounds, so the exchange rate appreciates (more demand for pounds). Similarl less incentive to save in pounds so the exchange rate depreciates (less deman
   (b) When the exchange rate is high, import prices fall, since they appear relatively currency. Similarly, when the exchange rate is low, import prices rise, since th terms of the domestic currency.
   (c) Low import prices lead to lower inflation (since the price of import goods form So, following the chain all the way through, a rise in the interest rate reduces i 'exchange rate channel').
   Similarly, high import prices lead to higher inflation. Therefore, a cut in the int channel.

*Test your knowledge*

1. (a) Deflation is when interest rates are negative (1). Any month/period between D
(1), you could also have Sep-15 or Feb-16.
(b) Disinflation is where the interest rate is falling (but not necessarily negative) (1
graph where inflation is falling (e.g. May-11 to Jan-15) (1).
(c) The correct answer is C. The easiest way to answer this is by eliminating the ot

A cannot be right because the index is lower in Feb-13, even though inflation w

B cannot be right because the index is lower in Feb-14 than Feb-13, even thou
period.

D cannot be correct since it shows a rise in the index between Feb-14 and Feb
actually slightly negative for this period.

The actual calculation for the right answer is:
Feb-13 index = 100 * 1.019 = 101.9 (plus 1.9%)
Feb-14 index = 101.9 * 1.007 = 102.6 (plus 0.7%)
Feb-15 index = 102.6 * (1 – 0.003) = 102.3 (minus 0.3%)

*Extended-response question*

1. Your answer should first explain some of the roles a central bank should play in an e
are likely to lower the interest rate to stimulate the economy, and they may also ha
supply and/or trying to boost market confidence and credit creation in the econom
recession.

Your answer should evaluate whether the central bank can expect to solve the prob
are several ways in which the bank might be constrained:

- **Interest rates might already be very low, which limits the central bank's abili**
Central banks tend to be reluctant to let interest rates fall below zero, as this r
markets. Recently, however, some central banks have allowed interest rates t
of Japan and Sweden)
- **Banks might not be able to stimulate credit growth if market confidence is lo**
UK after the financial crisis: despite large amounts of quantitative easing, cred
reflected uncertainty about the future of the economy and consumers and bu
is only so much a central bank can do in this case.
- **The central bank has no control over fiscal policy.** Since the central bank only
limited control over how the economy performs. During recessions, it is likely
be needed to stimulate the economy in addition to monetary policy measures

## Case Study 5: Market failure in the financial sector

*Use the data*

1. Figure 2 suggests that the UK was more exposed to a financial crisis, since the total
a proportion of GDP.

2. It fell from around 14,000 to around 7,000, a fall of 50% (accept (45–55%) or 7,000

3. Examples of arguments for **more** regulation (not exhaustive):
   - Prevent future crises
   - Protect consumers
   - More stable economic growth

   Examples of arguments for **less** regulation:
   - Free-market functions better without government interference
   - Banks should be allowed to fail so they make better decisions in the long run
   - Could enable more consumers to access credit (in the absence of any future cr

   There is no right answer to this question, it may be the case that there are specific a
regulated.

*Test your knowledge*

1. Possible answers include: to facilitate saving, to facilitate lending, to facilitate the e
provide markets for equities, currencies or commodities. 1 mark for each correct answ

2. Negative externalities are not mentioned. (1) In the case of the financial crisis, whe
to risky customers, they do not consider the full social cost of this action (1) (which

*Extended-response question*

1. The central bank (the Bank of England in the UK) has many different roles to play in
   - **Setting monetary policy** – the base interest rate set by the central bank influe financial sector. Furthermore, the central bank can provide liquidity to financ (one way of lending to banks to increase the money supply). This helps facilita and households.
   - **Regulating the financial sector** – the Bank of England plays an important role requiring banks to hold certain amounts of capital in case of a crisis. They also promote competition in the financial sector, as well as monitor the overall sta
   - **Lender of last resort** – the central bank can provide emergency funding to fina crisis, to prevent a bank run (which is when people with deposits at the bank l withdraw their money at the same time – this happened to Northern Rock in t
   - **Promoting financial stability** – the central bank is charged with maintaining co financial system as a whole. It achieves this through the functions mentioned guidance' strategy, where the bank announces future policy changes in advan won't be any sudden surprises.

   Your answer should clearly explain two or three of these points.

   Note: Since the financial crisis, regulation of the financial sector has been delegated England including the Prudential Regulation Authority (responsible for making sure excessive risks), the Financial Policy Committee (responsible for monitoring threats and the Financial Conduct Authority (responsible for protecting consumers and pro sector). You don't need to know any of these details for the exam.

## Case Study 6: Canada's economic policies

*Data response question*

1. GDP per capita = $50,000 and population = 35 million, so GDP = $1.75 trillion. Gove money terms:
   Government debt = 1.75 * 0.865 = **$1.5 trillion**
2. Figure 2 states that energy consists of 10% of GDP. GDP is $1.75 trillion, so energy i
3. Canada's population is 35 million, and Figure 2 states that 16 + 1.8 = 17.8 million pe
   So the percentage of Canadians in employment = (17.8 / 35) * 100 = **50.857%**
4. From Figure 2: roughly **16%** (accept 15–17%)

*Test your knowledge*

1. We would expect the % of government spending as a share of GDP to increase, so the graph should show an upward trend over the next few years. 1 mark for identifying increase / upward trend.
2. You can either show an increase of both AD and AS on one diagram, or show them on separate diagrams. 2 marks for labelling, 1 mark for shift in AD, 1 mark for shift in AS. Note: the eventual effect on the price level will depend on how you draw the curves: in this graph no change in the price level is shown but an increase/decrease is also correct.

*Extended-response question*

1. You could structure your answer either by talking about short-term positives/negat talking about all the positives over both the short- and long-term and then moving o approach:

   **Short-term benefits**:
   - Boost to employment leading to boost in economic growth. Potential for mul

   **Short-term costs**:
   - Possible inflation if AD shifts significantly (since AS takes a while to catch up)
   - Increase in budget deficit. Could reduce market confidence, increasing interes effects, if markets have faith in the long-term economic benefits of the plan.

   **Long-term benefits**:
   - Greater efficiency/productivity (evaluation: this is assuming that the infrastruc not go over budget)
   - Higher potential economic growth rate

**Long-term costs**:

- Potentially higher debt repayments (depends if the benefits from the higher g
- May have to lay off workers who were employed only temporarily

You could draw an AD/AS diagram to illustrate your answer, or simply refer to the c (rather than drawing it again). You can conclude that the policy would be beneficia long as it is well justified (e.g. you may argue that it would be good because Canada or you may decide that it would be bad because Canada faces falling export prices, lo

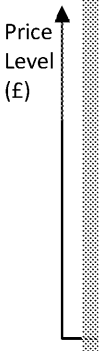
## Case Study 7: Productivity – the key to long-run growth?

*Use the data*

1. (a) Australia
   (b) Finland
   (c) Capital input – this has had a positive effect on every country's growth.
   (d) About 2% (between 1.5% and 2.5% acceptable)
   (e) Ireland gained 1% from capital input, but lost a little over 2% from labour inpu net result is a GDP growth rate of around –1.4% (between –1% and –1.8% acc
2. Spain has suffered from severe unemployment since the recession (as well as very l probably why the graph shows such a heavy loss in GDP from falling labour input.

*Test your knowledge*

1. Diagram should show a shift to the left in aggregate supply. Up to 2 marks for correct labelling, up to 2 marks for showing the shift correctly.




2. Possible factors include: technological improvements, changes to regulations, demographic changes, migration, competition policy, infrastructure investment, improvements in the healthcare system (other examples are possible if they can be justified). 1 mark for each factor.

*Extended-response question*

1. The benefits of this policy are clear: increasing productivity increases LRAS, which increases the ability of the economy to grow in the long run (greater p illustrated using a diagram – it may also be helpful to explain how better education Several evaluative comments could be made, including:
   - Opportunity cost involved with funding the scheme
   - Possible that more money could be spent on education, but actual quality of e
   - Economic growth would only occur if demand keeps up with supply
   - If everyone becomes better educated, it may be harder for people to find jobs supply of skilled jobs increases
   - Long time lag between starting the policy and seeing results: politicians may n reason

## Case Study 8: Ireland's housing market bubble

*Data response question*

1. (a) If average income is €30,000, and long-term average house prices are eight tir average price of a house in Q4 1980 is:
   8 * 30,000 = €240,000
   (Since in Q4 1980 the index = 100)
   (b) In Q1 2007, the index of 166.2 shows house prices are 66.2% higher than the b 2007 would be 240,000 * 1.662 = €398,880.
2. The answer is (c) – it is impossible to determine. Since the prices are all in index fig house prices. Even though Ireland's house prices were proportionally higher in 200 the UK could have been higher to start with.
3. We know from Figure 2 that China's real house prices have followed a modest upw can't be explained by falling house prices. A more likely explanation is that the ave steadily: this is a fact you should be aware of (China has single-handedly lifted a sta poverty in the last few decades).

*Test your knowledge*

1. (a) Ireland's house prices increased rapidly from Q1 1993 to a peak in Q1 2007 (1 around 2012 (1), when prices slowly began to pick up again.
   (b) The index number for Q1 2007 is 344.1. This indicates that (real) prices are 3.4 (when the index number was 100). Any answer between 3 and 3.5 times large

2. Ireland's fiscal policy consisted of increasing government spending and reducing tax budget = tax revenues – government expenditure, this should lead to a budget defi can make arguments that in the long term lower taxes lead to higher tax revenues, mark for identifying fiscal policies, 1 mark for explaining how they lead to a deficit.

*Extended-response question*

1. Your answer should note that deregulation of markets is traditionally seen as positi capacity of an economy, shifting LRAS to the right. This should be shown on an AD/ labelling, and shift in AS shown correctly). You could explain that freeing businesse is generally seen as positive (it often increases employment), and that it may enhar and encourage foreign investment into the country (as it did in Ireland's case). It al unlike many other supply-side policies (e.g. education).

   On the negative side, clearly in Ireland's case too much deregulation was a bad thin behaviour to emerge. If financial institutions cannot effectively self-regulate, then or oversee the industry to some degree. On an AD/AS diagram, you could potentia AS (during the boom) following by a fall in AS (during the recession) – this is not rec conclusion should mention that the effectiveness of deregulation depends on the d the industry to start with.

## Case Study 9: World economic superpowers: is the USA's reign over?

*Use the data*

1. Allow 5% either way
   (a) 30%
   (b) 40%
   (c) 10%
   (d) 25%

2. (a) Accept anything between 2% and 3%.
   (b) Accept anything between 10% and 11%.
   (c) If USA's growth was 2.5%, then in 15 years US GDP = 15 * 1.025^15 = $21.7tn. in 15 years China GDP = 6*1.105^15 = $26.8tn. China's GDP is larger (should g values given in (a) and (b)).

*Test your knowledge…*

1. (a) GDP per capita is GDP (the total value of output in an economy in a given time population size. (1)
   (b) Since China's population is so large, switching to GDP per capita figures means does India). (1)

2. (a) The idea behind PPP is to adjust for the costs of living in different countries by of different currencies. (1)
   (b) In the USA, $100 wouldn't buy as much as it would in China. When we accou appears relatively larger than before. If the Figure 3 figures were not PPP adju considerably larger than China's. (1)

3. Possible answers include:
   - market reforms
   - low unit labour costs OR international competitiveness (not both)
   - high levels of saving
   - currency devaluation
   - trade liberalisation
   - high levels of inves
   - investment in forei

   1 mark for each (max of 3)

*Extended-response question*

1. GDP measures the total value of output in an economy. When you adjust for popu
standards (PPP) this can give a good impression of the *size* of an economy. Howeve
the *success* of different economies, many important factors are omitted:
   - **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.

## Case Study 10: Brexit and trading blocs

*Use the data*

1. Possible economic arguments in favour: higher GDP (or GVA), higher employment,
entry for firms, lower financial transaction costs, harmonisation of product standar
consumers.

   Possible economic arguments against: no membership costs, increased ability to fo
economies, removal of unnecessary regulations for firms.

2. The contribution to UK employment of exports to the EU has fallen steadily since 20
around 3.15 million in 2014 (numbers don't need to be quoted). One possible reas
global economy following the financial crisis. A similar answer would be the ongoin
economies (e.g. Greece).

*Test your knowledge*

1. A customs union is a free-trade agreement between countries (1) characterised by
outside the customs union. (1) Note that a customs union is less integrated than a
does not usually include free movement of goods and people (you don't need to sta

2. Possible disadvantages could include:
   - Damaging for economies outside the free-trade area
   - Loss of industries / unemployment in certain domestic industries, as they are
international stage (winners and losers)
   - Potential for excessive/inefficient bureaucracy to emerge (particularly around
regulations)

   There are other general disadvantages of free trade in general you might mention (
commodity, could be disastrous if the market crashes).

*Extended-response question*

1. Possible **benefits** include:
   - Lower transaction costs (no need to change currency)
   - Elimination of exchange rate uncertainty (which may hold back trade – particu
   - Transparency (price comparisons are easier)
   - Trade creation and job creation (mostly as a result of the other factors above)
the context of a single market, not a monetary union): see Figure 1. You may
trade may have been just as high outside the EU.

   Possible **costs** include:
   - Initial cost of changing currency
   - Loss of independent monetary policy (this is very important in the Eurozone.
countries needed different levels of expansionary monetary policy: since the E
'one size fits all' monetary policy caused problems for many countries.)

- Loss of exchange rate flexibility (in the EU, some countries lost out because th decline, but the euro didn't decline as strongly as they would have liked due t such as Germany).
- Asymmetric shocks (similar to the previous points: if one economy experience harder to formulate an appropriate policy response)

In your answer you should talk about the conditions in which a monetary union wo participating economies are similar in nature) and when they would be unsuccessfu are very different).

## Case Study 11: Subtle protectionism

*Use the data*

1. A country may wish to restrict the supply of exports if it believes it can generate hig supply low (and hence prices high). This is particularly effective for countries that h certain goods.

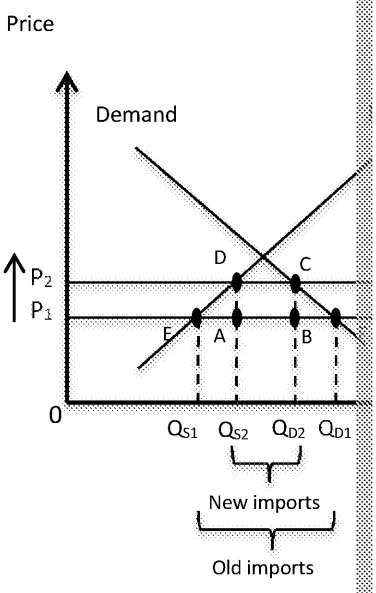
2. On the one hand, the increase may be because there was a legitimate rise in concer However, it could also be a back-door attempt to restrict imports without violating coincided with the financial crisis).

*Test your knowledge*

1. Tariffs are charges that affect the **prices** of particular imports (or exports) (1), wher **quantity** of imports/exports. (1)

2. In the short term, it is likely that the current account balance will improve (larger su value of imports should fall (1). This could hold true in the long term as well; howev trading partners will retaliate, cancelling out the improvement in the current account balance or worsening it (2).

3. Your diagram should show an upward shift in the world supply (which is perfectly elastic). (1) Price increases from $P_1$ to $P_2$, (1) and quantity demanded falls from $Q_{D1}$ to $Q_{D2}$. (1) Previously, imports were $Q_{D1}$ minus $Q_{S1}$ (1), now they fall to $Q_{D2}$ minus $Q_{S2}$. (1) Deadweight losses are shown by areas EAD and BFC. (1) Tariff revenue is the area ABCD. (1) One more mark for correct labelling of axes and demand/supply curves.




*Extended-response question*

1. Imposing a tariff on imported cars makes it more expensive to buy imported cars, and makes domestically produced cars relatively cheap. At a basic level this should reduce imports (since prices are higher), increasing the (X–M) component of AD. However of demand for imported cars: if demand is highly inelastic, consumers will accept th imported cars, which would lead to a fall in (X–M) (remember: X–M refers to the va exports).

   A tariff also influences the other components of AD. The government generates m may allow it to increase its spending (and a rise in G contributes to AD).
   If consumers switch to domestically produced cars, this will support job creation in industry. This should lead to an increase in consumption (since these newly create workers).

   However, in your answer you should consider the effect of retaliation. If foreign co cars exported from the UK, this could negate the positive effect on domestic emplo AD).

## Case Study 12: Mozambique – an African lion?

*Use the data*

1. Clearly Mozambique's GDP growth rates have been much higher than the UK's sinc without having to look at a graph for the UK). Also, Mozambique seems to have be financial crisis of 2008.

2. (a) GNI is the total income of all a country's citizens across the world (whereas GD within a country's borders, regardless of nationality).
   (b) Output/income per person, rather than in total.
   (c) PPP (purchasing power parity) means that the figures are adjusted for the cos country.

3. Since the expected years of schooling (for children entering school) is significantly g schooling (calculated for those aged 25+), this indicates that the education dimensi

*Test your knowledge…*

1. Other possible indicators could include: poverty rate, literacy rate, access to clean v child mortality, environmental sustainability (although these are often linked to the

2. Possible answers include: abundance of natural resources / international trade, enc economic policies, foreign investment.

*Extended-response question*

1. Your answer should note that having abundant natural resources can help boost ec development), but not in all cases (on this point you should mention the resource c may also note that economic growth does not guarantee economic development. factors that can improve development aside from having natural resources, e.g. ed good financial system, health, demographics, investment, savings and debt.

   It is expected that you will conclude that natural resources can help boost develop managed, but that it is only one of many potential factors that can contribute to eco