Zig Zag Education

Economics

AS/A Level | OCR | H060/H460

Data Response Case Studies

For AS/A Level Year 1 OCR Economics: Macroeconomics

Second Edition, February 2022

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Contents

Teacher's Introduction

This resource is designed to be used for teaching OCR AS Level Economics Component 2: Macroeconomics. It is designed to be co-teachable with A Level, covering only 'Year 1' topics. The resource consists of 17 Data Response Case Studies intended for students to complete as homework tasks.

The case studies are presented in specification order, collectively covering each topic in the AS Level specification. Each case study contains detailed information (including diagrams and data), and tasks and questions.

The 'Use the data' tasks focus particularly on quantitative skills, and the 'Test your knowledge' mainly on AO1/2 knowledge and application skills. The extended-response questions are an opportunity for students to practise higher-level analysis and evaluation skills. Most of the questions given are in exam style, although we have not limited questions to this style except in the case of the extended-response questions. Detailed answers are provided for all tasks and questions.

Reading through each study and answering the questions is expected to take 20–30 minutes, not including the extended-response questions at the end of each case study. One option for using these is to work through a case 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 and A Level exam, but also stimulate an interest in the real-world applications of macroeconomics. Each case study uses real data, introducing the student to a fascinating array of contemporary and historical issues relating to the UK economy.

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

March 2018

Update v2, February 2022
Minor updates to match 2019 specification: case studies have been rearranged to reflect the new divisions between Year 1 and Year 2 content. The case studies contained in this resource are as below.

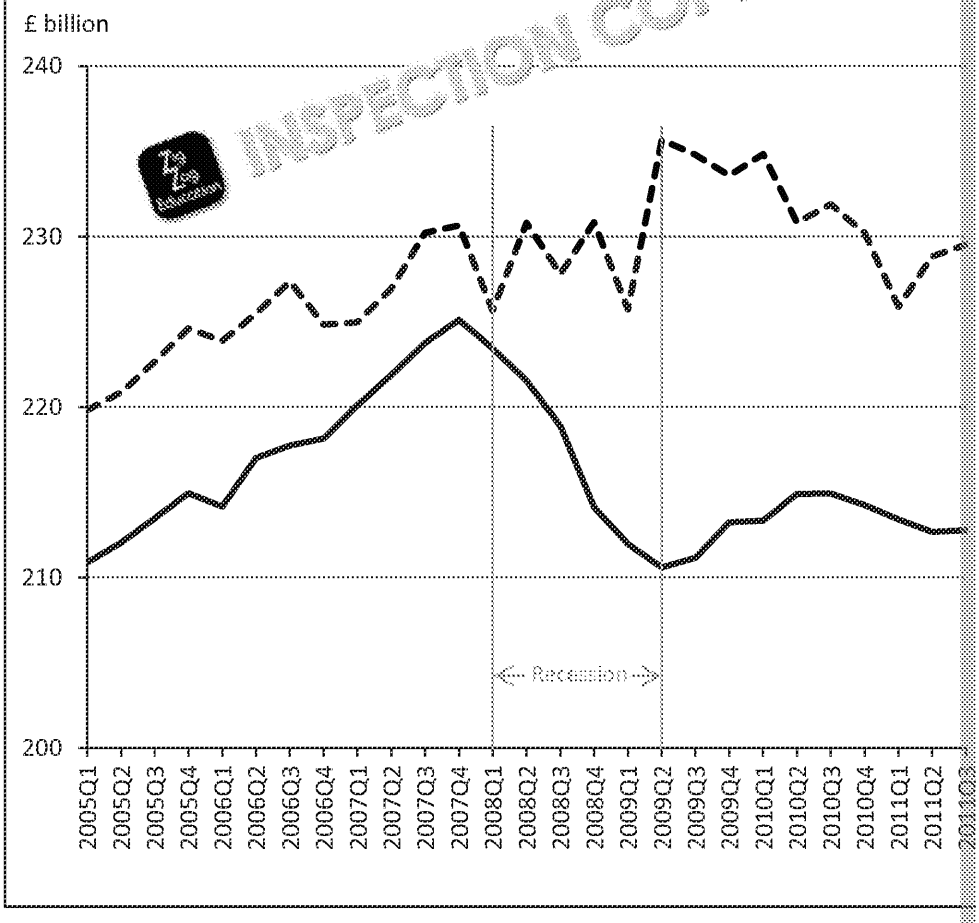
Case Study	Spec reference
1. The UK's slump in consumption during the recession	Aggregate Demand and Aggregate Supply – 'Aggregate Demand (AD)'
2. The economics of immigration	Aggregate Demand and Aggregate Supply – 'Aggregate Supply (AS)'
3. Economic growth in the UK – back to business as usual?	Economic Policy Objectives – 'Economic Growth'
4. Mozambique – an African lion?	Economic Policy Objectives – 'Economic Growth' and 'Development'
5. Youth unemployment in Italy	Economic Policy Objectives – 'Employment'
6. UK unemployment – successes and challenges	Economic Policy Objectives – 'Employment'
7. UK inflation in the 1970s	Economic Policy Objectives – 'Inflation'
8. Canada's economic policies	Implementing Policy – 'Fiscal Policy'
9. Greece's debt problem	Implementing Policy – 'Fiscal Policy'
10. Monetary and fiscal policy in the Great Depression	Implementing Policy – 'Fiscal Policy' and 'Monetary Policy'
11. Ireland's housing market bubble	Implementing Policy – 'Fiscal Policy' and 'Supply-side Policy'
12. Supply-side policies – privatisation in the UK	Implementing Policy – 'Supply-side Policy'
13. Productivity – the key to long-run growth?	Implementing Policy – 'Supply-side Policy'
14. Policy conflicts – inflation and unemployment	Implementing Policy – 'Policy Conflicts'
15. China and exchange rate management	The Global Context – 'International Trade' and 'Exchange Rates'
16. Should we be worried about the UK's current account deficit?	The Global Context – 'Balance of Payments'
17. When will the UK raise interest rates?	Various topics in Component 2

The UK's slump in consumption during

This case study requires knowledge of the topic 'Aggregate Demand.' You should of AD and the influences on these components (particularly c

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 Di a le Income



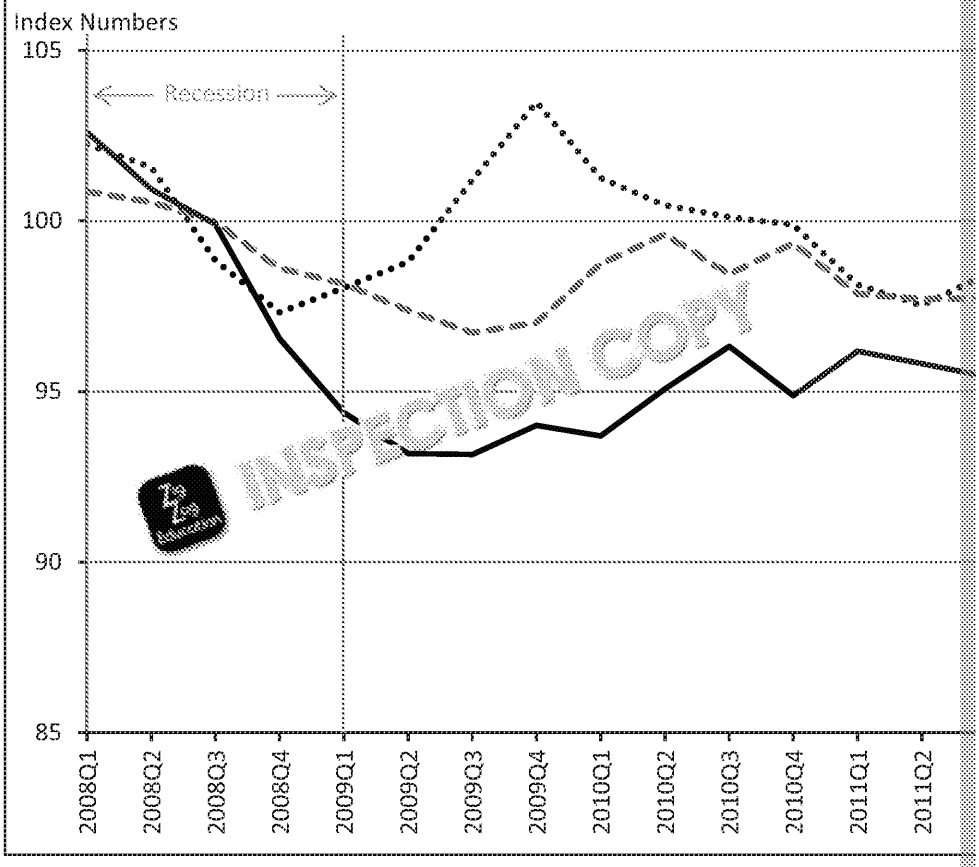
The Labour government at the time attempted to reverse the trend using many tools, such as adjusting taxes (e.g. lowerin AT and increasing the income tax threshold), bailing o nancial sector, and relying on the Bank of England t r interest rates (interest rates fell steadily from 5.75% i down to 0.5% by 2009 Q2.

It is intere o c pare the trend in disposable income with the trend in ho ld 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 staple
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 hig
non-discretionary goods and services?

Test your knowledge

1. Define [illegible] Demand (AD).
2. What is the formula for aggregate demand?
3. By approximately how much did household spending fall between its highes
as shown in Figure 1?
4. Using an AD curve, show the effect of a fall in the rate of VAT.

Extended-response question

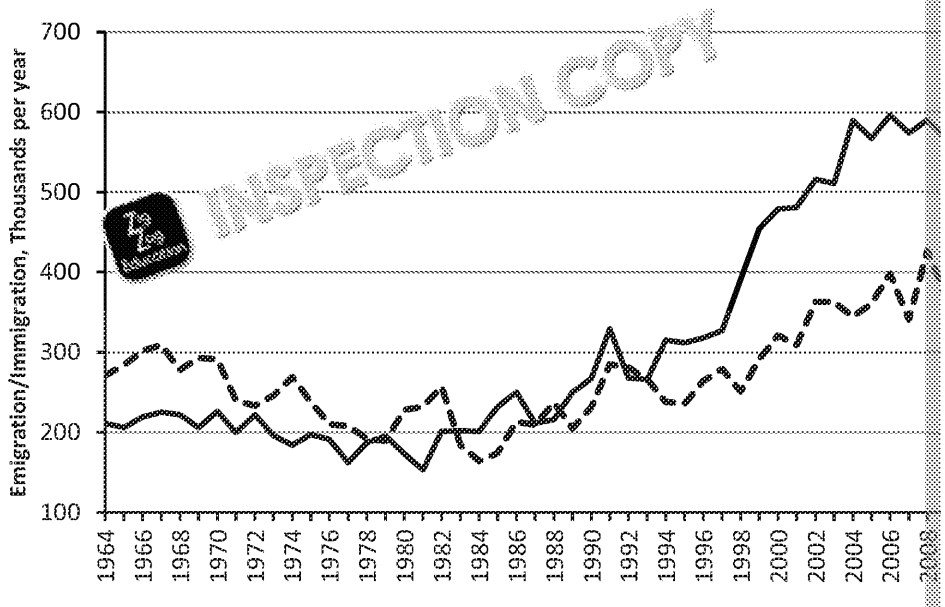
1. Discuss the relative importance of interest rates and consumer confidence i
demand.

The economics of immigrati

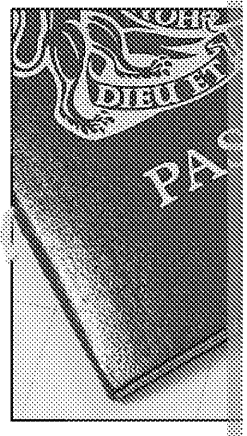
This case study requires knowledge of the topic 'Aggrega

The humanitarian crisis in Syria has revived old debates about the effects o '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 i 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 emplo and wages may be only temporary.

Evidence on this is mix US, some studies have found small, negative effects on native wag European studies have tended to produce 'statistically insignificant' results (meaning that the estimates of t wages are probably close to zero). On the other hand, there is some evide that immigration instead reduces the employment levels of natives (peopl due to the greater competition for jobs).

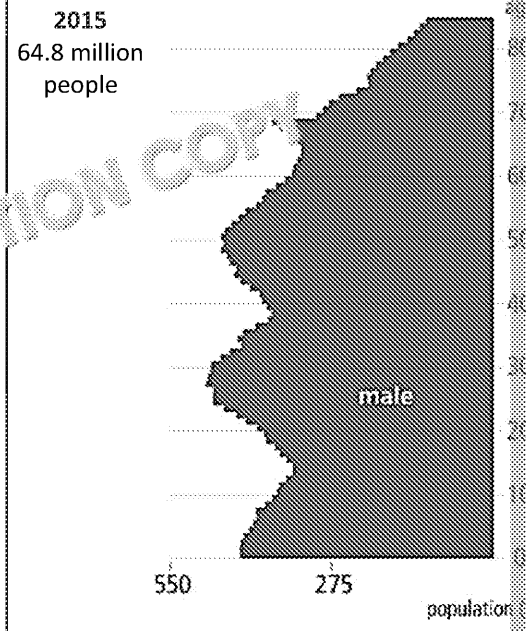
The differences in results may be because labour protection laws in Europ quite inflexible (or 'sticky'), but the labour market in the US is more *laissez*

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 o

The econo guments 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 o



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 after 50 years?

Test your knowled

'Net migrati th nce between immigration and emigration – an annu
100,000 inc hat 100,000 more people immigrated into a country than emig

1. Estimat net migration into the UK in 2010.
2. Briefly describe the trend in net migration from 1964–2014.
3. Distinguish between short-run aggregate supply and long-run aggregate sup
4. 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.

Economic growth in the UK – back to bus

This case study requires knowledge of the topic 'Economi

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 b[illegible] many commentators and external orga[illegible]s (such as the IMF) are optimistic about the futu[illegible] UK economy – not least since economic g[illegible]h [illegible]topped that of all the other 'G7' countries ([illegible]ure 2).

Figure 1: UK real growth rate

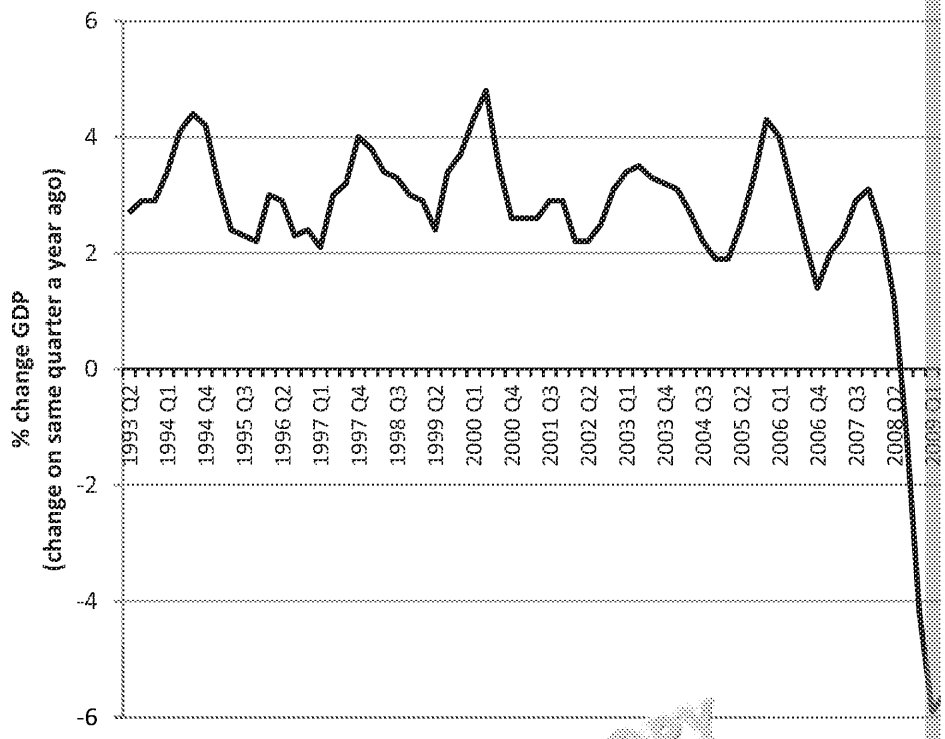


Figure 2

G7 Co[illegible]	UK	Canada	USA	Germany	Fra
2014 annu[illegible] 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 Chancel 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). Others
government spending more gradually would have led to more reliable gro
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 expan
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 i[illegible]toriously difficul
on forecasts is a risky move. There are some [illegible]ea[illegible]ats to the UK and th
including a slowdown of economic g[illegible]n China, and a chronic shorta
market. Hopefully the fore[illegible]ers [illegible]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. How does it differ from *nominal* GDP?
2. Why is GDP measured?
3. Give two reasons from the passage why the UK's growth rate was relatively
4. Explain **one** cost and **one** benefit of economic growth.

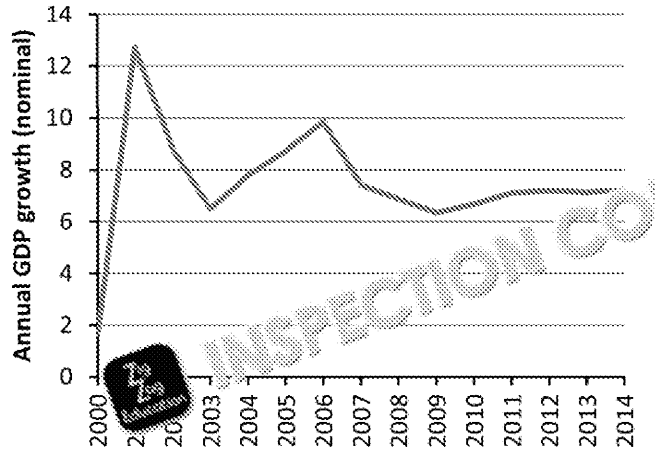
Extended-response question

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

Mozambique – an African lio

This case study requires knowledge of the topic 'Economic Growth'

Figure 1: Mozambique's GDP growth 2000–2014



Figures are in constant 2005 US$

Source: World Bank.

African economies
in the media – for
perception of Afri
under-developed
However, there ar
number of African
footsteps of the A
economic growth
among these stella
Having shed its co
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 and
to a strong currency (the metical) and high levels of foreign investment int

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 managemen
education spending and policies to promote competition. Mozambique n
business hubs, complete with shopping centres, restaurants and traffic jam

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:

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

Health

Education dime

Figure 2

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

Sou

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.

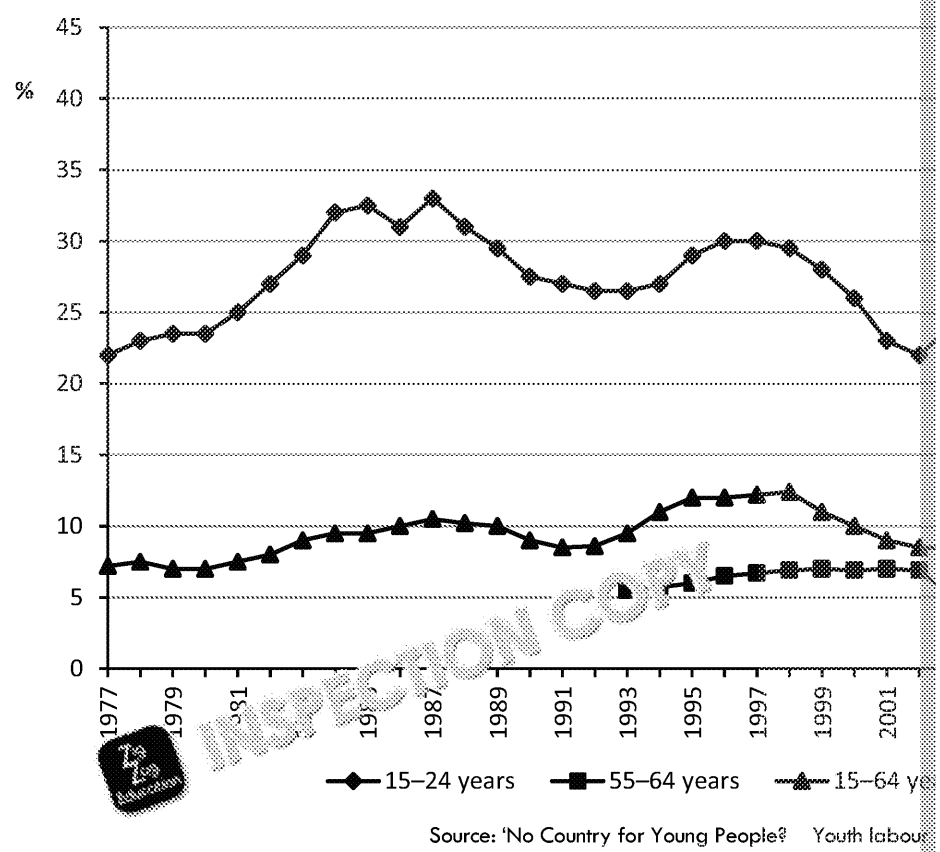
Youth Unemployment in Ita

This case study requires knowledge of the topic 'Unemployment

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 20[illegible] is 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 results

Figure 1: Unemployment Rates



Source: 'No Country for Young People? Youth labou

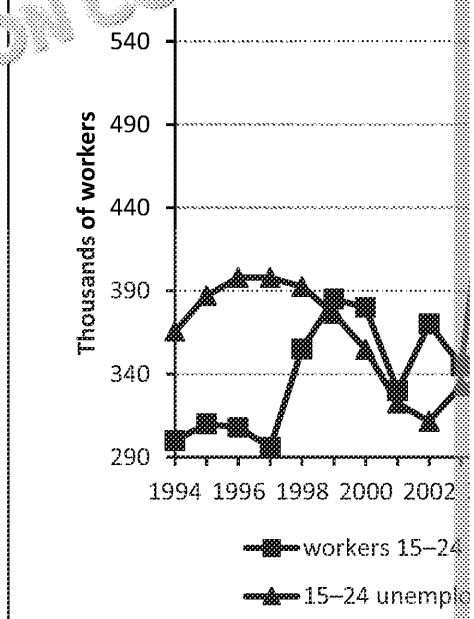
Research conducted by the Centre for Economic Policy Research (CEPR) s
explanations for the rise in youth unemployment rate:

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 graduate jobs has not kept up. In economic terms, this is referred to as structural unemployment.

The fear is that 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 a



Source: 'No Country for Young People? Youth l

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...

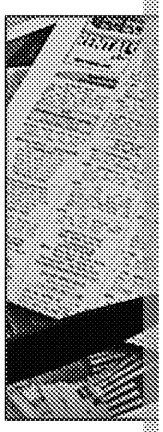
1. One of the reasons for the rise in youth unemployment was that more youn
   study, rather than participating in the labour force. Explain how this leads t
   using the formula.
2. State two types of unemployment not mentioned in the text.

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 th

UK unemployment – successes and

This case study requires knowledge of the topic 'Employment/U



Unemployment refers to the situation in which an individual is actively seeking employment, but is unable to find work. 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 cr[illegible] unemployment following the crash, as Fi[illegible] and 2 show, but since 2013 the situatio[illegible] improved dramatically.

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

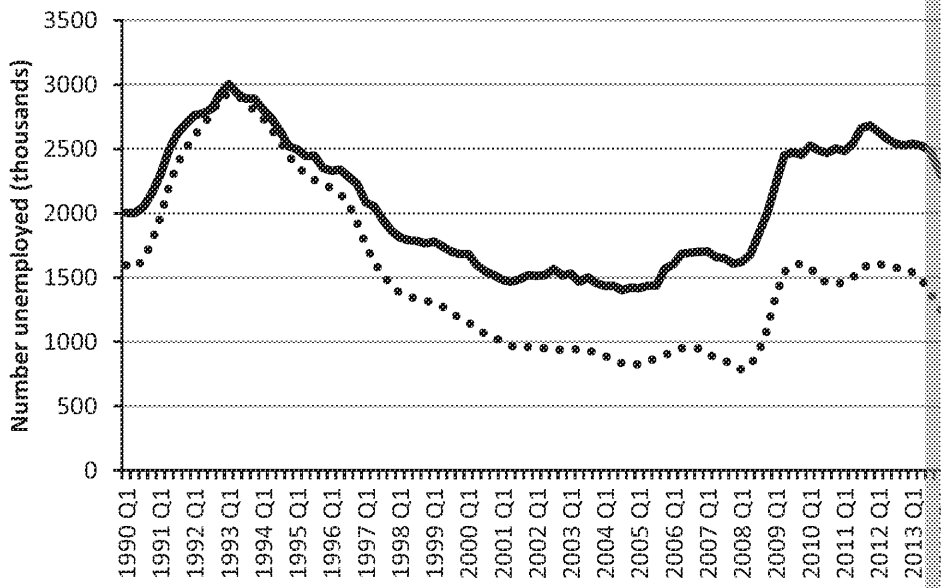
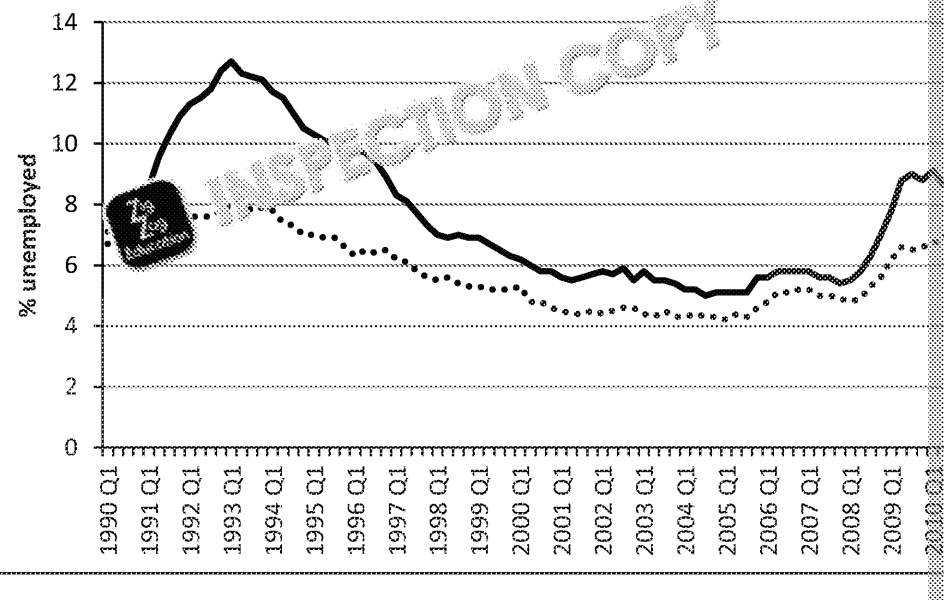


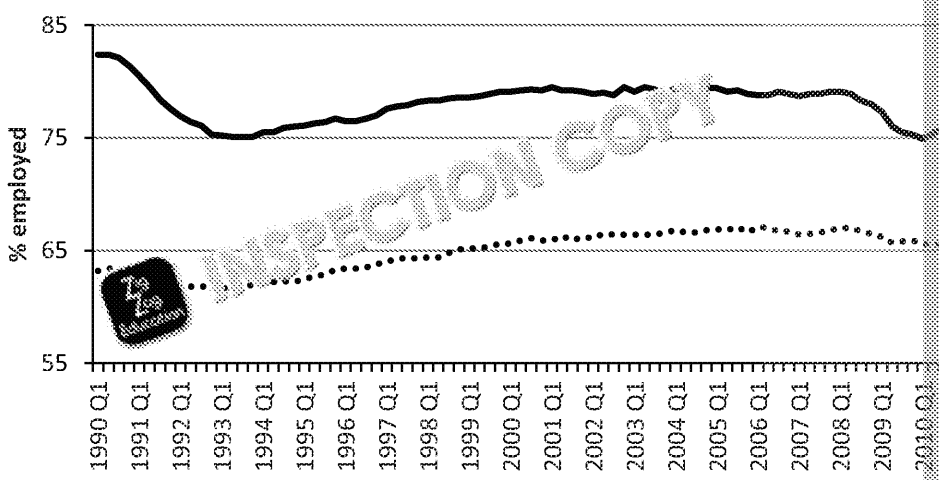
Figure 2: Unemployment rates (male/female)



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 indust
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 havi
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 1 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. Why is 'full employment' a macroeconomic policy objective?
3. Figure 1 shows a rise in unemployment numbers during the financial crisis o
type of unemployment that is likely to have taken effect during this time.

Extended-response question

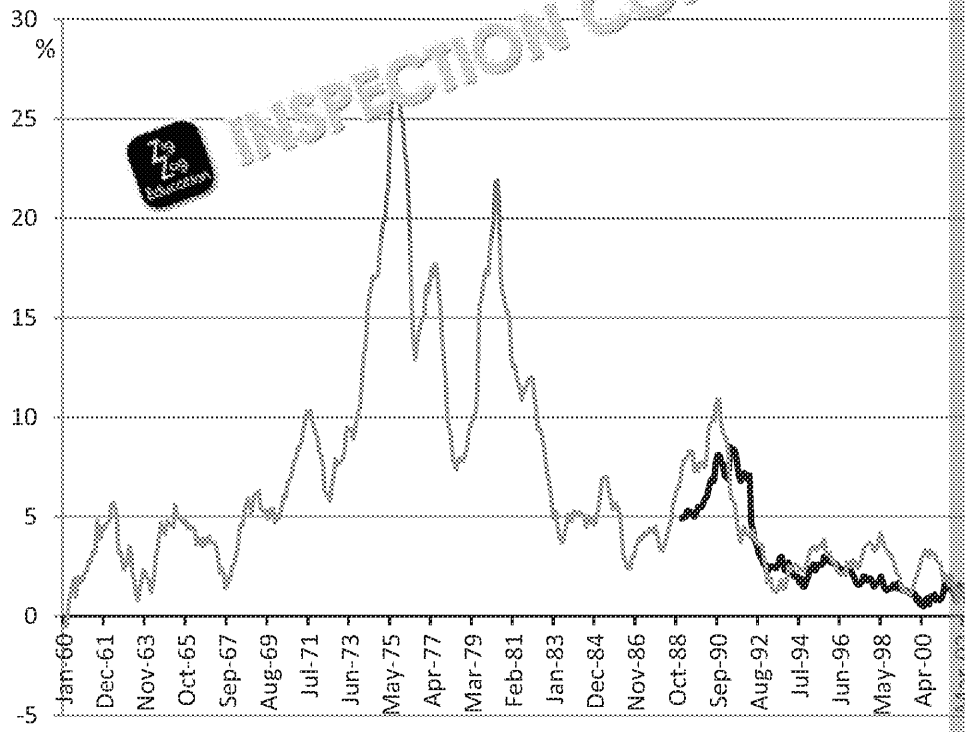
1. Discuss the consequences of unemployment for the economy and society.

UK inflation in the 1970s

This case study requires knowledge of the topic 'Infla

Inflation refers to the sustained increase in 'general' prices in an economy changes in the Consumer Price Index (CPI). Inflation figures in the UK ter sections of newspapers nowadays. Inflation has been very modest over th close to the Bank of England target of 2%) although the near-zero rate in 2 However, in the 1970s (and to a lesser extent the 1980s) inflation was a ser

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 p 'shocks' in the world economy –, i.e. une c d increases in the price of oil. This caused a s w in the UK manufacturing industr (a key cost of production) as well as an w ney from the UK to foreign oil producers 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 ra ng e 1970s.

Test your knowledge

1. State o so why inflation increased in the 1970s.
2. Explain the difference between deflation and disinflation.
3. What is the difference between the Consumer Price Index (CPI) and the Ret
4. Distinguish between cost-push inflation and demand-pull inflation.

Extended-response question

1. Discuss the costs of inflation for an economy.

Canada's Economic Policie

This case study requires knowledge of the topic 'Fiscal

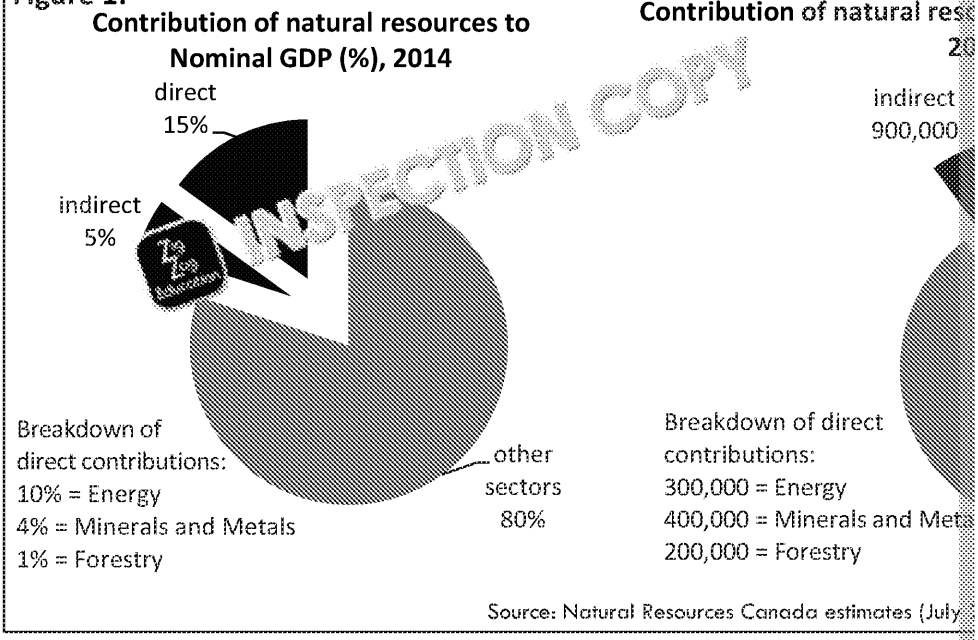
One of the basic questions in macroeconomics is: how can a government b Justin Trudeau, the Canadian Prime Minister elected in 2015, the answer i spending, funded by a temporary budget deficit.

Quick facts	Canada
Population:	**35 mi[illegible]n**
Area:	**9,[illegible]4,670 km²** **(2nd largest in the world)**
GDP per cap[illegible] (nominal):	**$50,000**
Governm[illegible]debt (% GDP), 2014:	**86.5**

The rationale for infrastructure spending is that it increases aggregate deman short term (e.g. directly through an increase in government expenditure; indi through an increase in consumption from workers involved in the infrastruct project) and it also boosts aggregate supply in the long term (as these investm boost the economy's productive capacity). Trudeau hopes to benefit from lo interest rates to fund a $60 billion (Canadian dollars) spending plan over 10 y channelled into areas including public transport, green projects and affordabl housing ('social infrastructure'). Around 30–35% of this spending is expected return to the government via higher tax revenues, as the spending induces m

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:

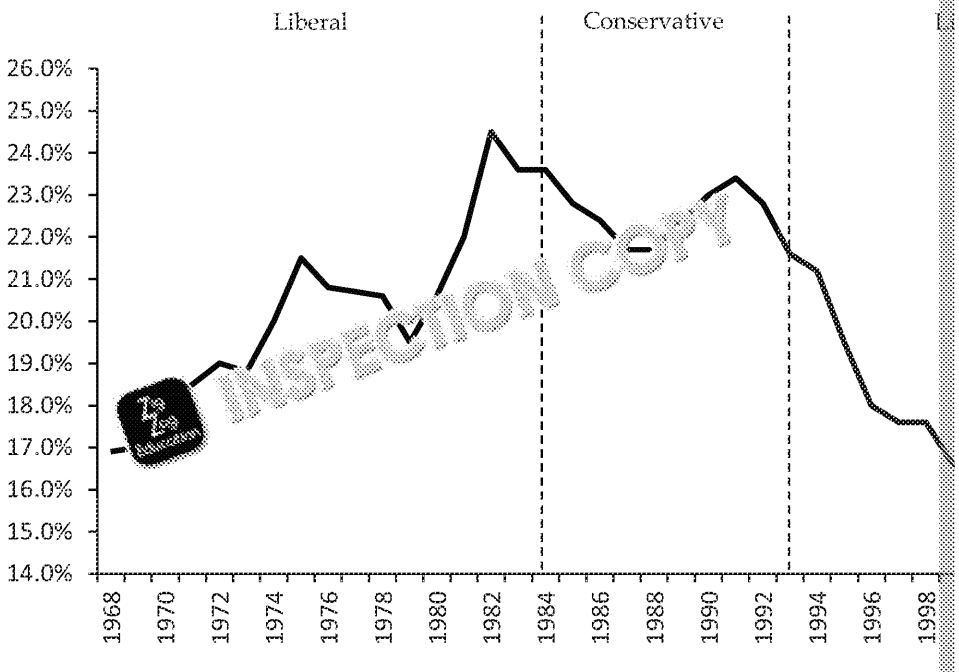
Figure 1:



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
the graph after 2008 could also be explained by the effects of the recession
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 recession 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.
3. Is Trudeau's fiscal policy suggestion a form of current or capital government

Extended-response question

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

Greece's debt problem

This case study requires knowledge of the topic 'Fiscal

Greece's sovereign debt crisis came to the forefront of European political a
aftermath of 2008's *Great Recession* and financial crisis. Its cause is rooted i

Members of the eurozone were required to sign the Maastricht Treaty, in w
budget deficits and sovereign debt levels in order to achieve a harmonious
however, incentivised Greece, and other southern European economies, to
accounting practices and the use of complex financial instruments in order
underlying budget and sovereign debt problems. Moreover, adopting the
finance private and government spending on more favourable terms than
country's currency. Eurozone countries benefited from reduced interest r
disparate levels of creditworthiness. Capital flooded rapidly into Greece a
prosperity in the region as the economy boomed. Finally, at the heart
fiscal irresponsibility. For instance, Greek ministers increased governmen
other welfare benefits markedly during this period. In fact, primary gove
by 87% while its tax receipts increased by only 31% from 2004 to 2009. Th
continuation of imbalances seen in Greece since the 1970s.

However, as the financial crisis began to take hold in 2008 it became clear
fundamental problems in their economy. Greece revealed that it had been
confidence in the economy fell instantly – for instance, ratings agencies do
bonds to 'junk' status. Greece's consistent budget deficits now appeared t
government bailed out its financial institutions, effectively transferring pri
Capital fled from the Greek economy, reversing the trend of the mid 2000s
increased markedly as a recession began. It became very clear that Greece
national debt.

Figure 1: Greece's Budget Position

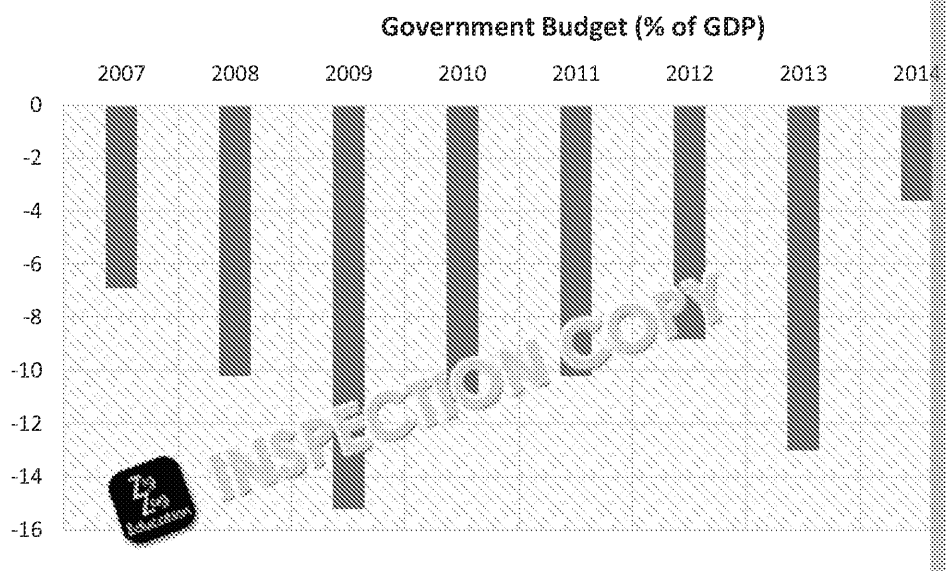
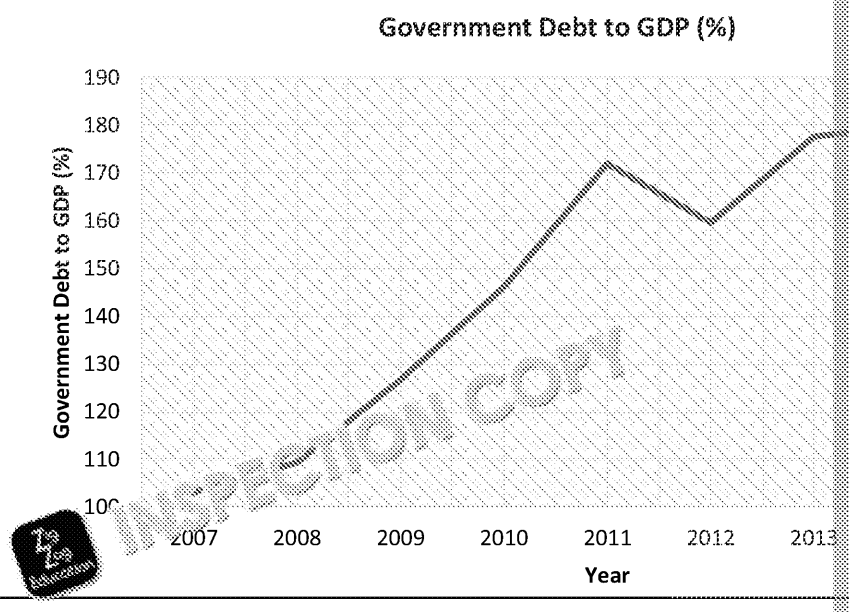


Figure 2: Greece's National Debt to GDP Ratio



Greece's fundamental problem is that it is a member of the eurozone. The in which member states share a common currency and, therefore, lose ind policy. The Greeks couldn't print euros in order to repay their creditors, n policy to erode the *real* value of their national debt. Furthermore, the Gree their currency to make them more internationally competitive, reduce cur improve GDP growth.

Instead, Greece had to use the limited fiscal policy tools it had available to try to influence the national debt. It increased taxation and cut governmer better its budget position – this is also referred to as 'austerity'. However, debt burden by decreasing GDP. Perversely, Greece also required further l from the International Monetary Fund in order to mitigate its government commentators have suggested that, instead of borrowing more and more, defaulted on its loans, freeing itself from the shackles of long-term debt – Central Bank would never have allowed. Greece's national debt currently and its economic future looks very bleak indeed.

Use the data

1. In which year was Greece's budget position the most concerning: 2007, 201
2. What was the approximate percentage increase in the national debt as perc 2007 and 2015?
3. Research why government debt to GDP fell in 20

Test your knowledge

1. 'It is suggested that Greece's tax policies have had the opposite effect than instan ro rtionately increased average rates of taxation on poor ho tax eva now a pervasive problem in the Greek economy, transactions many businesses are jumping ship to other European economies.'

   Based on the information above, would you say that the Greek government crisis is an example of a 'good tax'?
2. Distinguish between a government's budget deficit and the national debt.
3. Do you think that Greece's budget deficit is cyclical or structural? Why?

Extended-response question

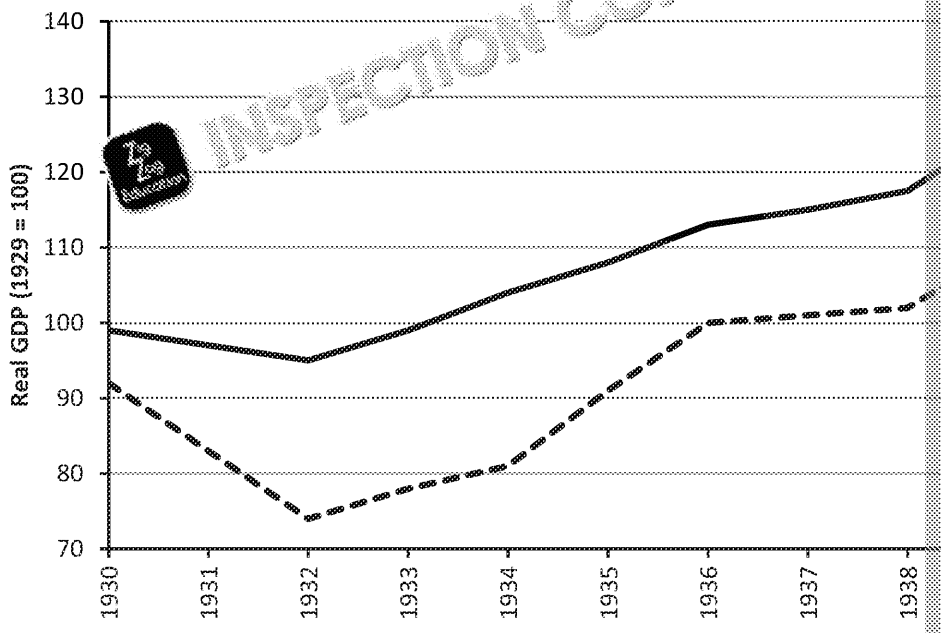
1. Discuss what policies governments can use to correct budget deficits.

Monetary and fiscal policy in the Grea

This case study requires knowledge of the topics 'Fiscal Policy' and

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:

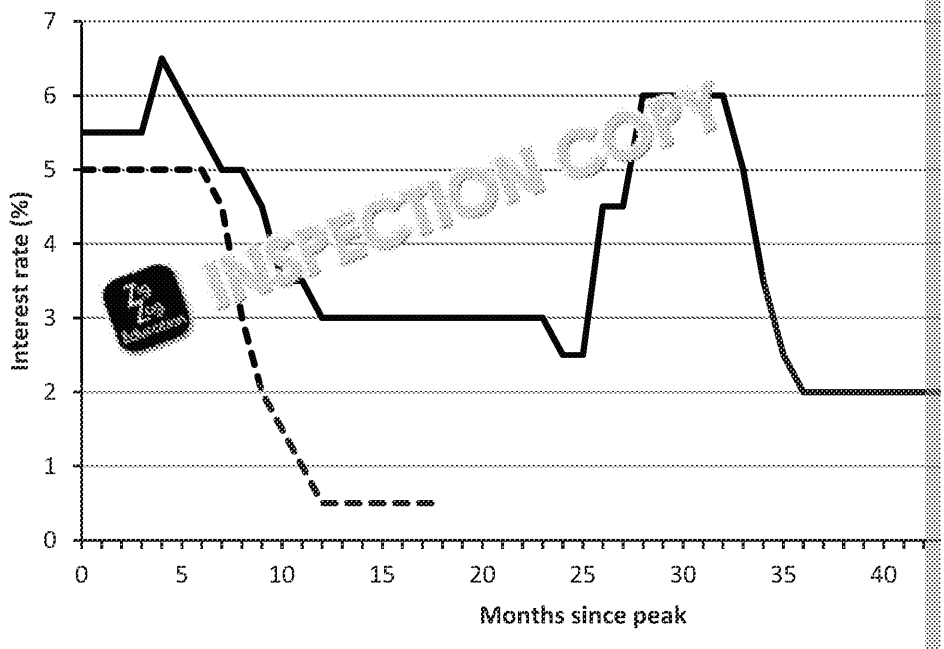
Figure 1: UK and US real GDP 1929–1940



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 wi[illegible] neighbours). When the UK finally abandone[illegible] Gold Standard in late 1931, the interest rat[illegible] safely be cut. This led to a depreciation of the pound, boosting the UK's competitiveness an[illegible] aggregate demand.

In terms of [illegible] policy, the government sought to correct the budget defic[illegible] cutting unemployment benefits and raising taxes. These are *contractionary* slow down the economy. Nevertheless, the economy did recover quite su[illegible] 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 [illegible] was enough to counteract the contractionary effects of fiscal policy. There[illegible] be drawn between the UK's response here and the response to the Financi[illegible]

However, economists should be cautious of drawing too many conclusion[illegible] from the experience of the Great Depression. The complexity of the situati[illegible] effect of any one policy on economic growth is almost impossible. Further[illegible] structured quite differently back then. For example, the budget deficit in [illegible] small relative to the budget deficit seen in 2007. Failing to learn from histo[illegible] 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 [illegible]
3. From Figure 2, how long did it take for the UK interest rate to fall from 5% to [illegible] Crisis?

Test your knowledge..

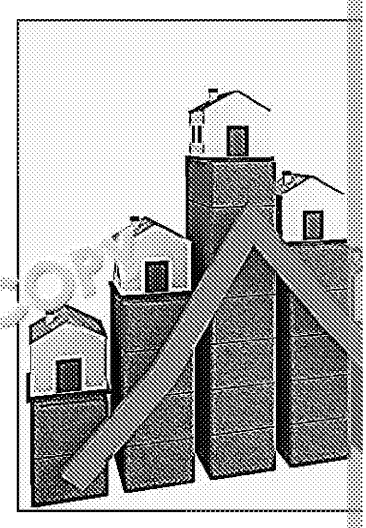
1. Approximately how [illegible] bigger (in percentage terms) was the UK economy
2. (a) Si[illegible] effect of a fall in the interest rate on AD using a Keynesian AD
   (b) Ex[illegible] two reasons why the fall in interest rates has this effect on AD.

Extended-response question

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

Ireland's Housing Market Bub

This case study requires knowledge of the topics 'Fiscal Policy' and



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 [illegible] in financial markets, [illegible] for Ireland's economic [illegible] 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[illegible] rich opportunities for Irish banks t[illegible] low rates (particularly following Ir[illegible] There was very heavy investment i[illegible] because this sector had never crash[illegible] confidence would prove to be misp[illegible] of investing, that investors should [illegible] range of assets, seems to have been

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

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

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 averag

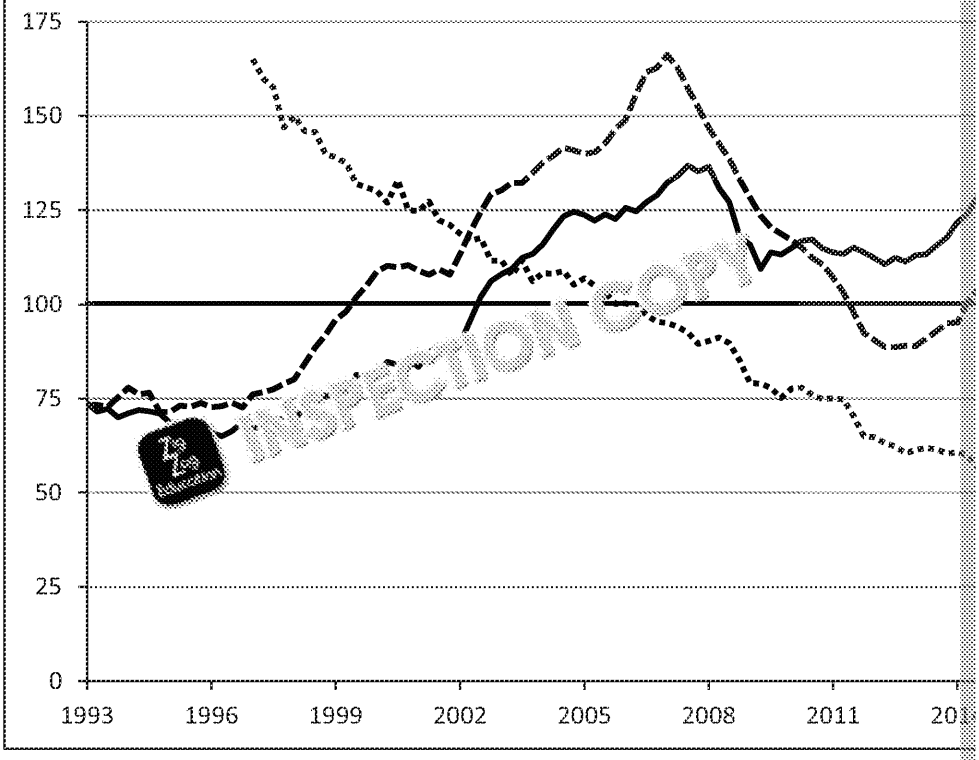
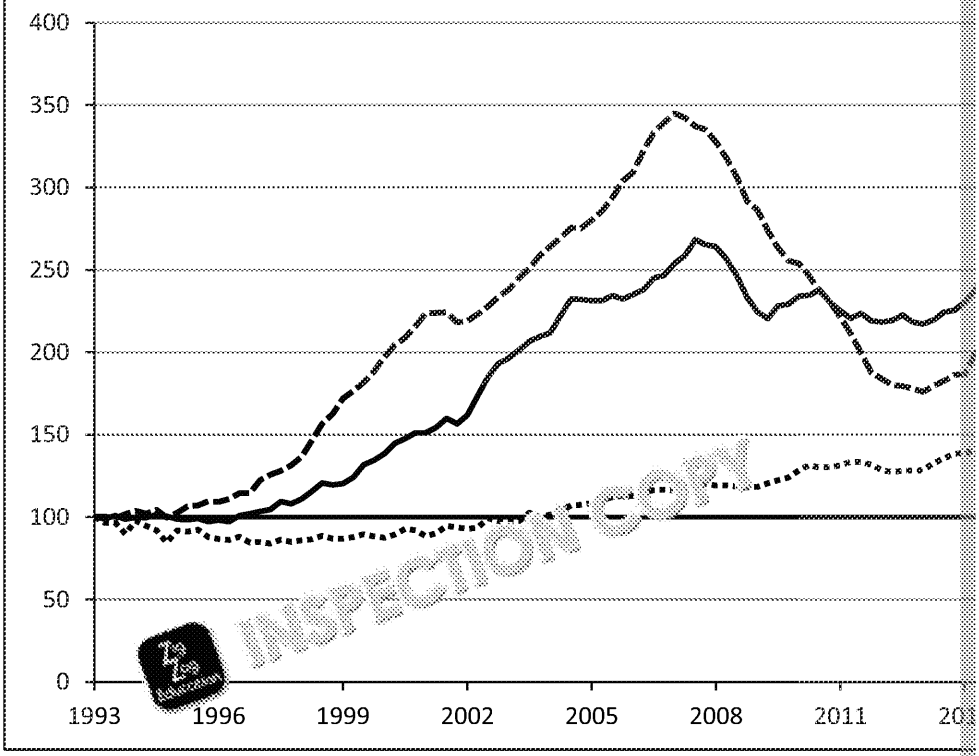


Figure 2: prices in real terms (base year = 1993)



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 aga

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 in
   (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 th[illegible] in house prices in Ireland over t
   (b) How many times greate[illegible]es in Ireland in Q1 2007 than Q1 199

2. (a) What is ma[illegible] 'budget deficit'?
   (b) E[illegible]wh[illegible]ther Ireland's fiscal policy measures described in the extrac
   a b[illegible] surplus or a budget deficit in the short term.

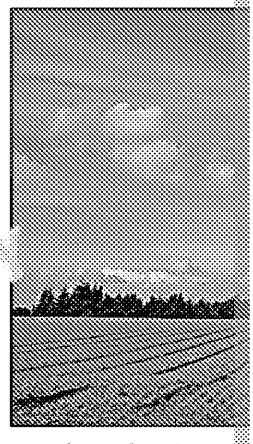
3. Using a Laffer curve, describe the relationship between the tax rate and tax

Extended-response question

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

Supply-side policies – privatisation

This case study requires knowledge of the topic 'Supply-si

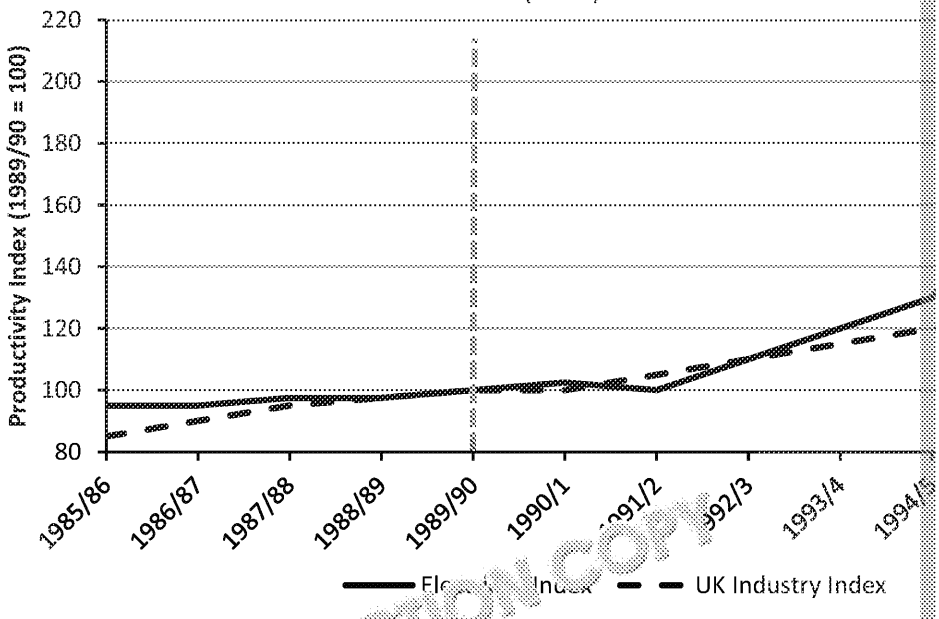


Supply-side policies, such as improving health and education, aim to increase the productive capacity of the economy. This allows for greater long-term economic growth. One of the larger (and more controversial) supply-side projects in the UK was the privatisation of nationalised industries in the 1980s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

The idea behind privatisation is th[illegible] competition in the market[illegible] efficiency, as private firms (motivated by profit) run themselves more effici[illegible] than the government can. In the UK, examples of industri 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 (200[illegible] he [illegible]ucturing and Privatisation of the Electricity Distribu

Figure 1 do[illegible]m 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

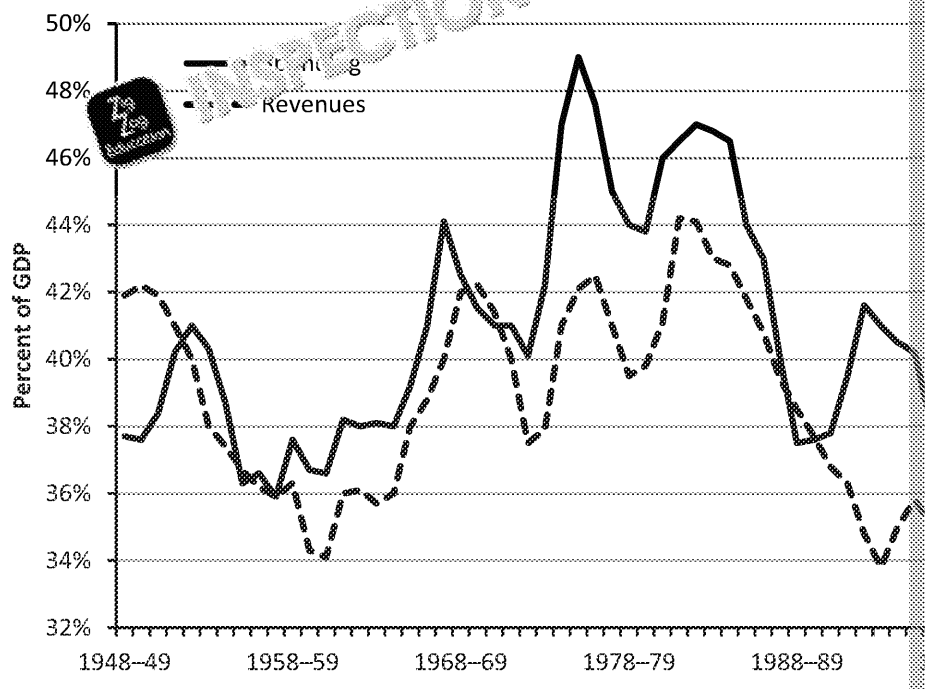
There was fierce opposition to privatisation at the time, causing deep divi that privatisation has failed, because market power has become concentra time, undoing any initial efficiency gains from competition (critics argue t electricity sector in particular, where a small number of firms dominate th

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 spend
the 1980s in Figure 2. Is th
3. Look at Figure 2. What ca
about the UK's tax rates during the 19

Test yo
ledge...

1. From t
sage, 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

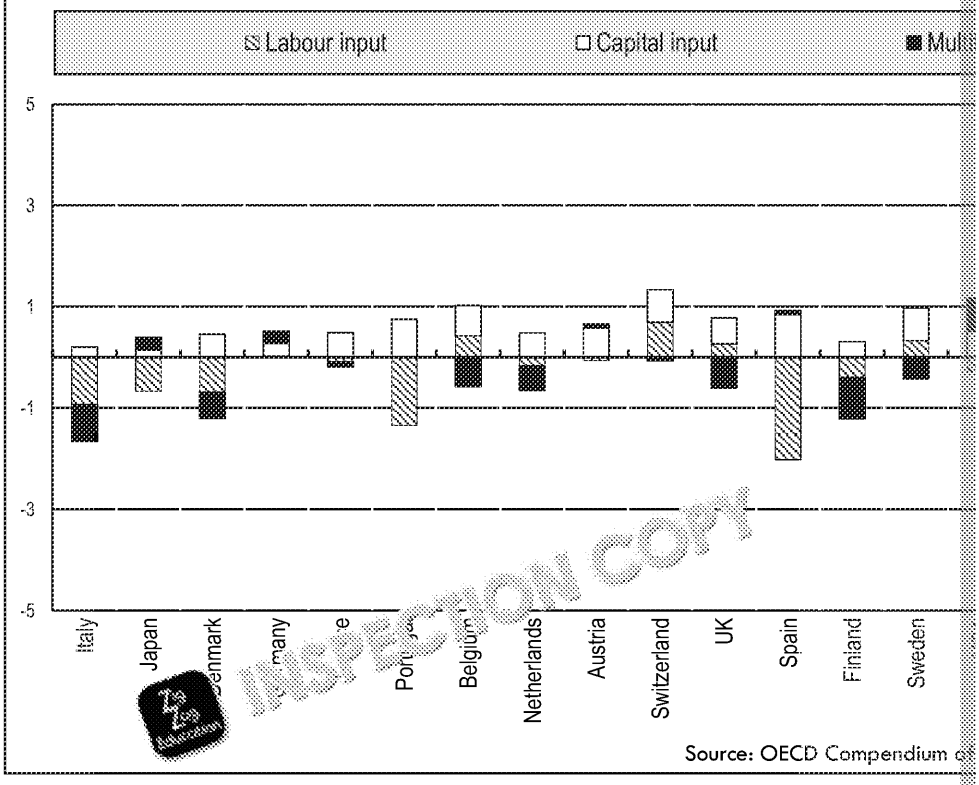
Productivity – the Key to Long-run

This case study requires knowledge of the topic 'Supply-si

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 work[illegible], perhaps by investing in capital or fundi[illegible]es [illegible]ch 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 O[illegible] Economic Co-operation and Development) is a group consisting of predo[illegible] countries.

Figure 1: Contributions to GDP growth: Total economy, annual percentage point



Source: OECD Compendium o

In Figure 1, labour input refers to the quantity of labour used in the econo[illegible] and non-IT) also refers to the quantity used. Multifactor productivity refe[illegible] 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 3). 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 be[illegible]ng from econom
idea of the division of labour (originally from Adam Smith).

Some economists are conce[illegible]d th[illegible]overall productivity growth has been
despite strong gro[illegible]th[illegible]e manufacturing sector (in the UK, it's estimate
the produ[illegible]f t[illegible]nsport equipment such as cars and planes increased b
productivit[illegible]o 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 classica
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.

Policy conflicts – inflation and unem

This case study requires knowledge of the topic 'Policy Conflicts'. Note that a f
Phillips curve is not required until A2.

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.

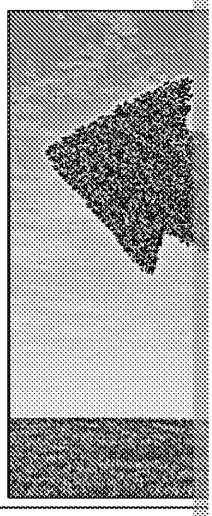


Figure 1 plots UK inflation and unemployment from 1971–2000 (each dot represents a year):

Figure 1: UK Inflation and Unemployment 1971–2000

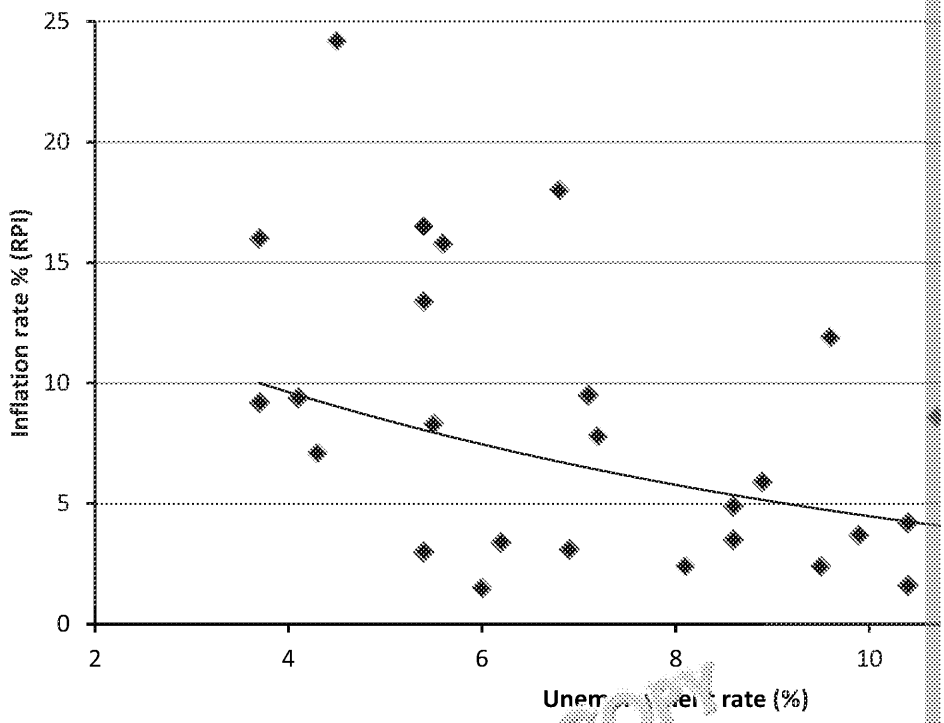
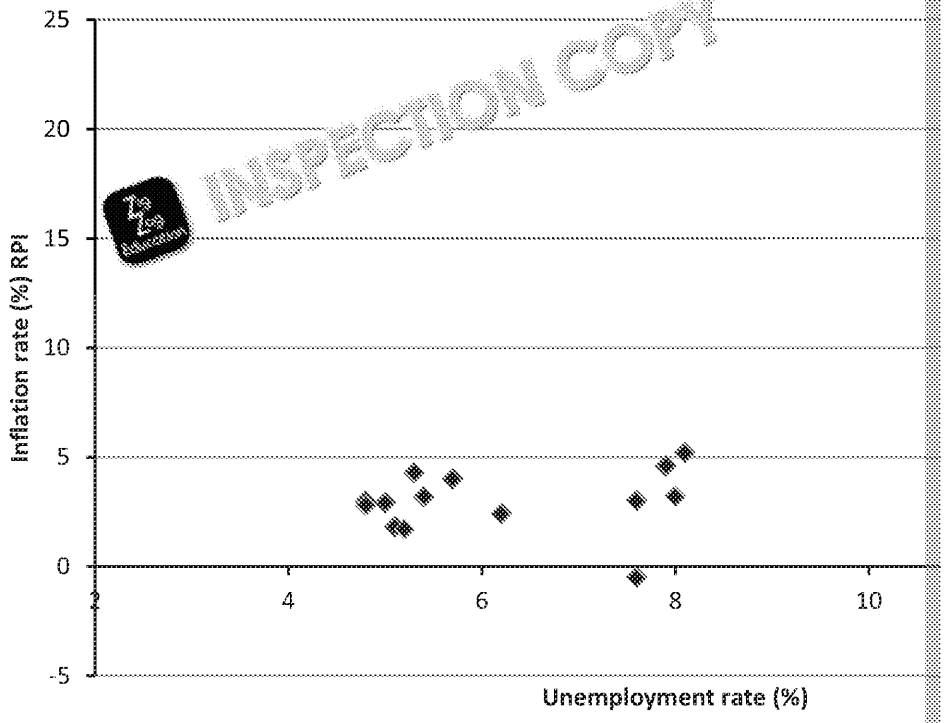


Figure 1 seems to show a ... pattern of the trade-off, although as with ... it is not nearly as ... the theoretical Phillips Curve. Inflation is measu... doesn't stretch that far. Data is available for after 2000, but the relati... (particularly due to the disruption caused by the financial crisis).

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. 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?
2. 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 what is meant by inflation targeting.
2. Explain why high unemployment may lead to low inflation.
3. Explain other possible policy conflicts.

Extended-response question

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

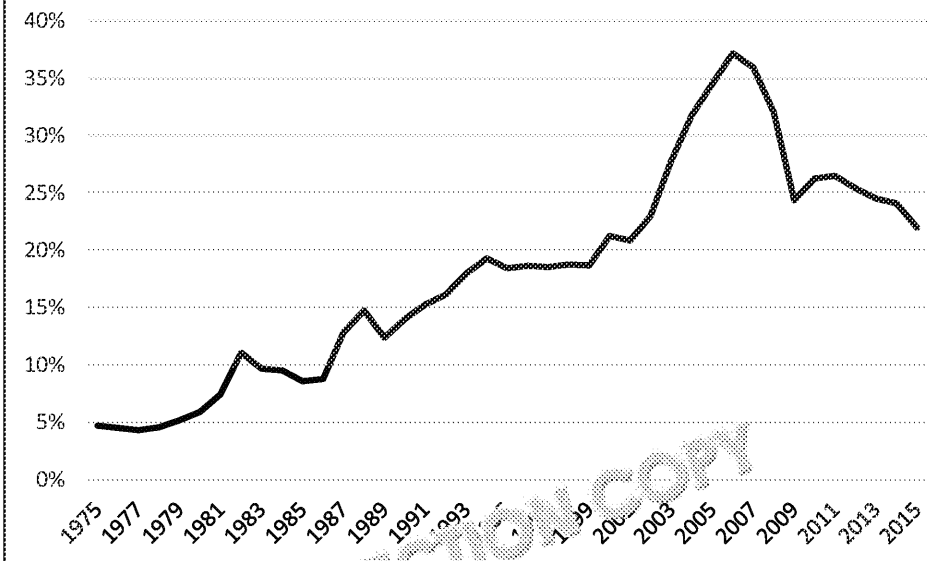
China and Exchange Rate Mana

This case study requires knowledge of the topics 'International Trade'

China's spectacular rise to becoming the world's second largest economic notable examples of the impact of international trade on achieving industr growth. When Deng Xiaoping, the then leader of the People's Republic of economy in 1978, few people could have predicted the rapid shift from an industrial powerhouse of the world.

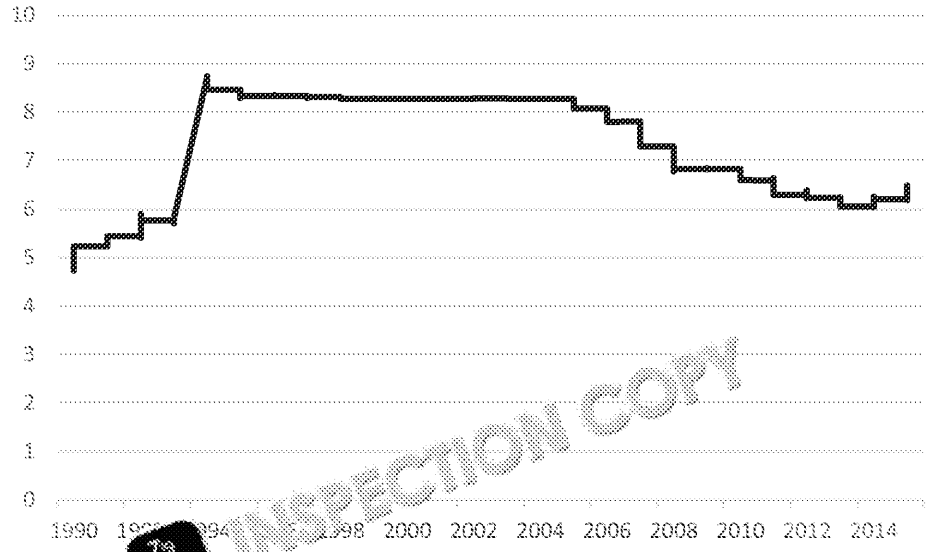
China's success is rooted primarily in its *comparat[illegible]vantage* in manufact means that one country can produce a certain product relatively more effi with a smaller opportunity cost. [illegible] some 1.36 billion inhabitants, it labour-abundant econo[illegible]ct, it is the most labour-abundant in the ripe for spe[illegible]production that uses this factor of production inte particularly [illegible]ctronics, occurs in China not only because labour is abun because it has gained expertise through specialisation. The Apple iPad's v $33, of which only $8 accrues to China. Apple could easily shift productio economies. Yet, industrial clusters in China can offer over three decades o manufacturing, thorough knowledge of the production process, sophistica logistics networks, design and engineering expertise and the ability to up- ease – this gives China a comparative advantage even if labour is a falling industrial manufacturing.

Figure 1: China's export growth (1975 to 2015) – goods and services as



Yet, China[illegible]yth in exports since 1975 hasn't occurred because of a con manufactur[illegible]g alone. The Chinese government first pegged the yuan (Ch dollar in 1995, and then to a basket of currencies – that is, it has been opera *regime*. It can be seen in Figure 2 that the Chinese yuan was almost flat be Chinese government allowed its currency to float within limits.

Figure 2: USD to CNY nominal exchange rate



Exchange rates are the price of currency in terms of another, and, therefore relative prices of goods and services across international borders. It is said be competitive on international markets because it artificially kept its curr yuan is now floating on international foreign exchange markets, the Chine allowed it to make the major adjustments in value that the international co appreciated by about 20% between 2005 and 2008, but critics speculate tha further 20% before it reaches the free-market, floating value. International Chinese government of currency manipulation that unfairly benefits its pr international markets. Western consumers, however, have likely benefited cheap Chinese exports.

For the Chinese, though, currency stabilisation is essential for long-term d production is export-orientated. China's domestic markets might not yet b the output of Chinese producers, and so targeting supply at foreign econo currency to compete on the international stage might just be the best strate aggregate demand. Moreover, outward-orientated growth has allowed Ch (partially) exposing itself to international competition – its comparative ad production has allowed it to do so. It's clear from Figure 1 that operating has boosted exports, and, therefore, GDP growth significantly.

However, fixed exchange rate regimes aren't c... es. Crucially, although helped exporters, imported products ... tu...y more expensive in Chin include natural resources and ... ts to the production process, even costs and producing '... ... inflation in the Chinese economy. Anothe central ba... o... manipulate the exchange rate by buying and selling supply and ...nd). It has, therefore, accumulated plenty of US financia giving up independence over its own monetary policy.

Use the data

1. China's GDP in 2006 was $2,752.68 billion. What was the value of its exports
2. Why do you think that Chinese exports fell from 2006 to 2008?
3. What is the percentage change in the USD/CNY exchange rate between 200 currency movement is this?

Test your knowledge...

1. Distinguish between *absolute* and *comparative* advantage.
2. (a) Define the terms of trade.
   (b) Imagine that the average price of China's exports increased by 2% while goods imported to China decreased by 6%. What would be the change
3. What is the difference between floating exchange rates and fixed exchange
4. Explain the effects of currency depreciation with reference to the J-curve ef

Extended response question

1. Chinese currency manipulation has clear costs and benefits to the domestic effects of this fixed exchange rate regime on the US economy.

Should we be worried about the UK's curre

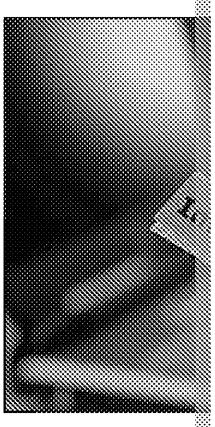
This case study requires knowledge of the topic 'Balance of
You should be familiar with the current account component of the balance of pa
to have some understanding of how exchange rates

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 perc[illegible]age of GDP

Quarter	Total	Trade	Primary
Q3 2012	[illegible]	-1.7	-0.
Q4 201[illegible]	-4.2	-2.5	-0.
Q1 [illegible]	-4.2	-1.7	-0.
Q2 2[illegible]	-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 f[illegible] unexpectedly (as with oil-producing countrie[illegible] 2015/16).

Running a current [illegible]deficit is nothing new for the UK: there hasn't b
But some [illegible]mi[illegible] are concerned about the size of the deficit: the figure
Q4 2014 is [illegible]gest 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 e
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 n
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 st
   (b) Which of the three components seems to have worsened over time (i.e
2. (a) Suppose UK GDP in Q3 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 size
   Q3 (quarter 3) 2014.

Test your knowledge...

1. What is the *balance of payments*?
2. Based on the article:
   (a) Explain the effect on the current account balance if the value of UK inv
   increased.
   (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.

When will the UK raise interest

This case study covers a range of Component 2 top

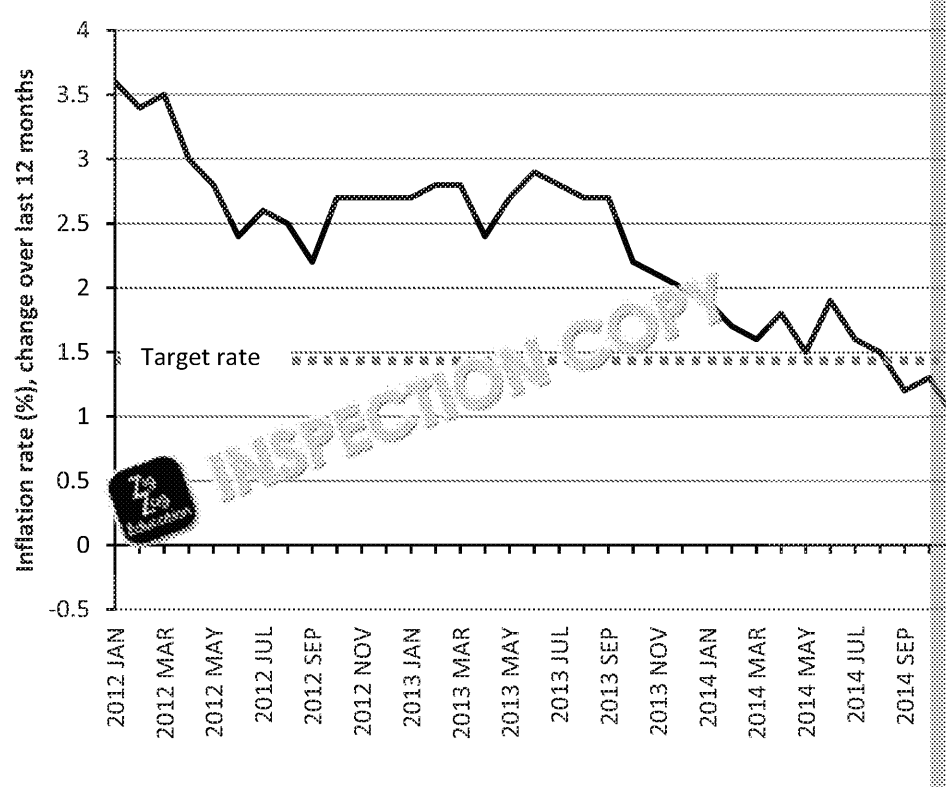
Interest rates are one of the key tools central banks use to guide the economy in the right direction. The Bank of England's Monetary Policy Committee meets every month to decide whether or not to change interest rates. In the UK, interest rates have been at a historic low of 0.5% since March 2009. Financial 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 has been more optimistic: the Federal Reserve increased 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 governor of the Bank of England – 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's 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

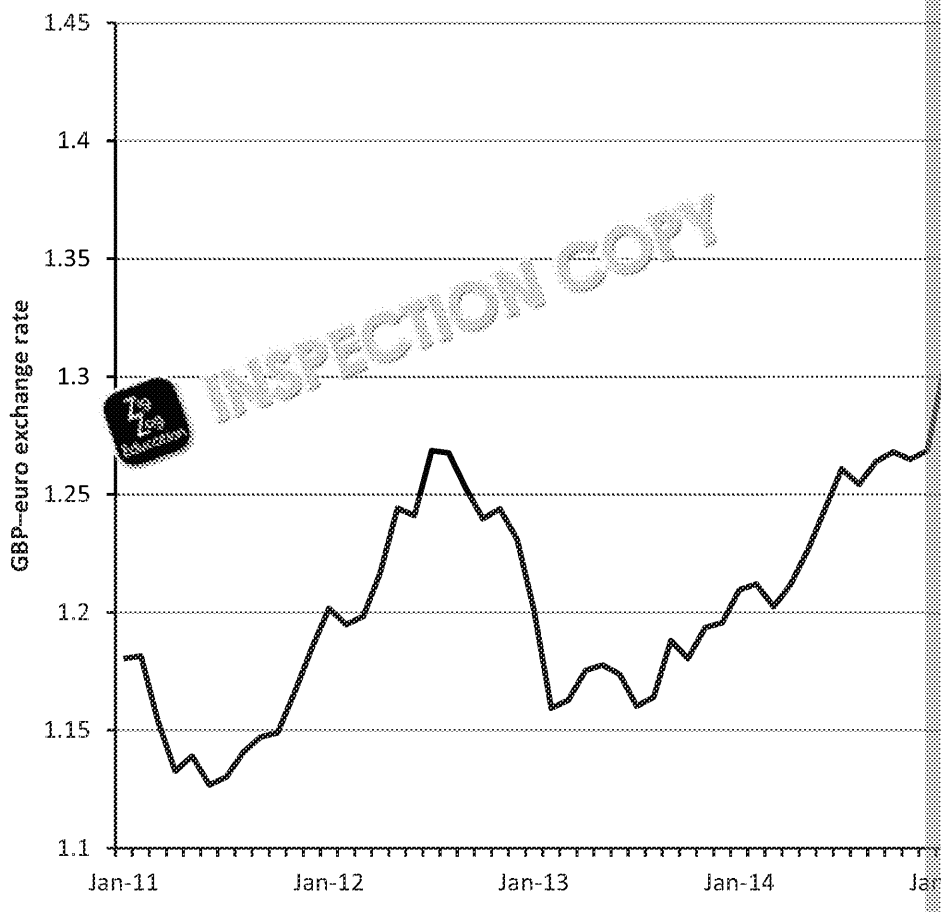
Another factor is the inflation rate. Traditionally, monetary policy is desig stable, positive rate. As Figure 1 shows, the UK has seen unusually low in years.

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 averag



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 poli

Use the data

1. Which of the following terms best describes the tren igure 1: (a) disinfl
(c) deflation?
2. Explain why deflation might be d g or an economy.
3. Suppose the GBP–E ge 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 logi[illegible]d appropriate for th
Evaluation (4)		
	0	No evaluation.
Level 1	1–2	Limited attem[illegible] eval[illegible]ion – may be only loosely related to the quest
Level 2	3	Accu[illegible]nced evaluative comments are made, supporting a roun re[illegible] 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 questi
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 concept[illegible]ow[illegible], partially linked to t or basic reasoning skills.
Level 3	7–10	Good knowledge of [illegible]le[illegible]nt economic concepts is displayed, lin evidence t[illegible]or[illegible]e main arguments. Analysis is well developed sid[illegible]gument.
Level 4	1	Kn[illegible]wledge of the economic concepts is very accurate. Links to the q 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 ques
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: 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 m 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. Aggregate demand (AD) is the total demand for final output produced within an ec

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

3. 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.

4. 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 C component of AD). Up to 2 marks for correct labelling, 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 belie
   - 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 w

Case Study 2: The economics of immigration

Use the data

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

2. (a) Around 200,000 (acceptable: 175,000–225,000)
   (b) Around 10. (acceptable: 5,000–25,000)

3. The labour force participation rate would increase.

4. The labour force participation rate would worsen, as the 'bulge' from the migration force (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 lar period of negative net migration, 1 mark for identifying period of positive net migra

3. Short-run aggregate supply (SRAS) refers to the situation in which there is at least o
Producers respond to changes in prices (brought about by movements in AD) by va
available to them. SRAS is shifted by changes in costs of production (1). Long-run a
refers to the productive potential of an economy. In the long run, all factors of pro
determined by *all* factors of production. LRAS shifts when the productive capacity o

4. 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 arti[illegible]at [illegible]an mention, both for and against th
include:
   - Increasing siz[illegible]a[illegible]ur force (evaluation point: more effective in countrie
   m[illegible]p[illegible], e.g. Japan)
   - Br[illegible]der range of skills (e.g. technical skills, language skills – boost to hu
   dep[illegible]ds on skill composition of migrants)
   - Migrants may be harder workers or contribute disproportionately towards ind
   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 m
   to draw an AD/AS diagram to show the increase in AS from migration (and a possibl

   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 3: 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 appea
positive in the UK). Therefore, the GDP growth figures w[illegible]e higher (also the re
Visually, the graph would appear to have shifted [illegible]p.

3. USA's GDP growth is given as 2.4% i[illegible]e t[illegible]o from a starting point of $17 trillion
(17 × 102.4) / 100 = $17.40[illegible]ion.

Test your kn[illegible]e...

1. GDP is t[illegible] value of final output (or goods and services) produced in an econor
period (1). 'Real' GDP means the effect of inflation has been removed. It is adjuste
dividing it by the GDP deflator (essentially an inflation index) (1). 'Nominal' GDP is s
produced. If *real* GDP wasn't adjusted to account for price changes, doubling the p
produced within the economy would double GDP, despite there being no actual pro
clearly misleading (1).

2. Measuring GDP is important because it is a simple indicator of the economic health o
value of GDP, the better off an economy is. This is because GDP can be understood a
or national income, or national output. Any of these three things being higher should
condition (1). It also allows us to track the rate of *economic growth* over time, as wel

3. Possible answers include: market confidence, low borrowing costs, low oil price, rev
1 mark for each identified factor. You cannot have the expansionary monetary poli
Statement (since this was after 2014).

4. Costs of economic growth: inflationary pressure, recession (if economic growth is *u*
degradation, inequality, current account deficit.
Benefits of economic growth: improvements in standard of living, increases in incom
government borrowing, investment, improvements in public services, social cohesio

1 mark for **each** cost and benefit. 1 mark for **each** explanation. Note, list of costs a

Extended-response question

1. GDP measures the total value of output in an economy. When you adjust for popul
inflation (real GDP) this can give a good impression of the *size* of an economy. How
compare the *success* of different economies, many im t factors are omitted:
   - **Living standards**. It can be more inform tiv to adjust GDP using the concept
   account for different living stand as ferent countries (PPP should be clea
   Accounting for living st ards to narrow the perceived gap between ri
   are usually relati h p poorer countries.
   - **In y**. per capita GDP figures give no indication of the distribution o
   ex e rapid economic growth, but this would not benefit the general pop
   to a ail 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 deve
   that there are problems measuring GDP itself –e.g., GDP not account for the size of
   illicit economic activity) – which varies greatly between countries; GDP only measur
   but not changes in *quality* which is arguably more important. A good answer shoul
   these points in depth.

Case Study 4: 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 cost
   country.

3. Since the expected years of schooling (for c re tering school) is significantly g
schooling (calculated for those a) has indicates that the education dimensi

Test your knowledge

1. Other in ators could include: poverty rate, literacy rate, access to clean w
child m and environmental sustainability (although these are often linked t
HDI). Happiness –measured through indicators such as Gross National Happiness –
development – although it's important to be aware of the Easterlin paradox that su
incomes don't necessarily correlate with higher levels of happiness!

2. Possible answers include: abundance of natural resources / international trade, end
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. . good financial system, health, demographics, investment, savings and debt. An imp that specialisation in the primary sector might keep a country such as Mozambique to specialisation in the tertiary sector.

   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

Case Study 5: Youth unemployment in Italy

Use the data

1. The 55–64 age group data shows a slight rise in th er oyment rate between 20 around 6%). The 15–24 age group also sho n ease, but a far more dramatic low of around 20% in 2007 to 40% y 13

2. (a) An increase of ar 0 (accept 10,000 either way).
   (b) Aft ma e in 1994, unemployment fell steadily until 2002. The nex pe e 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).
   - Reducing/removing employment protection regulation – a crucial barrier to yo excessive employment protection regulations that make it difficult for firms to recession. Firms, therefore, choose not to hire less-experienced youth worker expenses related to this situation. Removing such barriers could make hiring y effective. This policy potentially has adverse effects on worker's' perceptions

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 a ci onsequences of unempl

   Social consequences include increased d health problems, lower living stan possible family problems, a lo s i th long-term effects), or any similar justi

   It's important to co n all employment is a macroeconomic objective, e.g. th operati p ive potential. Therefore, economically, unemployment implie its prod apacity. The main economic consequences include lower economic g possible eflation (due to the lower economic activity), and a worsening government benefit payments increase, and tax revenues fall). The passage also mentions the pos

   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 and unemployment (again, this is temporary) and possibly cyclical unemployment (so lo too deep). It may be helpful to note that in the case of Italy, where unemployment unemployment) is so high, these types of unemployment cannot be as easily ignore

Case Study 6: 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 tha 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 eith or g (employed) (1) or look number of economically active people is th s m the size of the labour force. Y people count as economically act de ull two marks.

2. 'Full' employment is a macroeconomic policy objective for a number o unemplo his hat the economy is not operating at its productive capacit labour s es. Second, there are long-term effects of unemployment that a gov loss of s d hysteresis. Third, unemployment has fiscal costs for a government higher and tax receipts lower when there is unemployment. Finally, unemploymen crime, poor health, social dislocation. It is for these reasons that governments aim

3. 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 7: 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 ra flation (not to be co

3. Inflation in 1970 was around 5%, but increase ra idly a peak in the middle of th around 7–8% before climbing again ar s end of the decade to around 22%.

Test your knowledge...

1. The pass ot ease in oil prices and low interest rates (also known as lo of thes 1 r ark.
2. Deflatio en 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).
3. Consumer Price Index (CPI) is the UK's main measure of inflation. It is based on a b products, which are weighted according to consumption patterns. Retail Price Inde includes a different bundle of goods and a partially different demographic (1). For i consumption habits, as well as higher-income households, because consumption by the 'average' household. RPI also includes many items related to housing expendit council tax, etc.) that CPI excludes (1).

4 'Cost-push inflation' is inflation that occurs through increasing prices of inputs which terms of higher prices for final output (1). 'Demand-push inflation' occurs when ag supply causing the economy's general price level to rise (1).

Extended-response question

1. Your answer should explain clearly several costs of inflation, before assessing their s whether inflation can be beneficial in some ways). Possible costs of a high rate of in
   - **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 often
   - **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 infla (higher and more prolonged periods of inflation 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

Furthermore another evaluation point is that whilst there are costs of inflation, there ar prices might encourage consumption decisions because consumers feel that they might be ab future, falling prices also increase the *real* value of debt – transferring wealth from debtc real interest rates discouraging borrowing; if wages are 'sticky,' real-wage unemployment cannot decrease wages to match falling prices.

Case Study 8: 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 economy.

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.

3. Trudeau's suggested fiscal policy is an investment in infrastructure. It is, therefore, a 'capital' expenditure. It differs from a 'current' government expenditure because it is an investment concerned with producing a *future* benefit *current*.

Extended-response question

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

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

   Short-term costs:
   - Possible inflation if AD shifts significantly (since AS takes a while to catch up).
   - Increase in budget deficit (if the government isn't financing this expenditure w decrease in other government expenditure).

- Could reduce market confidence, increasing interest rates. Or it could have no faith in the long-term economic benefits of the plan.
- Expenditure as a fiscal policy might have the adverse consequence of 'crowding rates increase as the result of expansionary fiscal policy and this might disince
- Opportunity cost of government expenditure.

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:

- Government expenditure might outweigh government tax receipts and so this problems associated with national debt; this might include higher debt repaym the higher growth rate offset this or not), or difficulty b owing in the future.
- May have to lay off workers who were emplo o ter porarily

You could draw an AD/AS diagram to ill your answer, or simply refer to the d (rather than drawing it again). You a clude that the policy would be beneficial long as it is well justifi may argue that it would be good because Canad or you ma cid ould be bad because Canada faces falling export prices, lo

Case Study ece's debt problem

Use the data

1. 2015; its budget deficit amounted to about -15% of GDP (1).

2. Actual values for Greek debt to GDP are – 2007: 103.1% and 2015: 176.9% (1)
   Percentage change is given by the following formula:

$$\%\ Change = \frac{Change}{Original} \times 100$$

   Therefore, percentage change is 71.6 (1).
   (Note: allow some flexibility in students' answers as long as the estimated values fo reasonable.)

3. In 2011, the Greek government negotiated a 'haircut' on debts payable to private fi amounted to a 50% reduction in the debts owed by the Greek government. Therefo between 2011 and 2012 (1).

Test your knowledge...

1. A 'good tax' is based on the following four principles. First, it should ensure *equity* proportional to the ability of individuals to pay, or, in other words, it should be 'fair meaning that it should be difficult for people to avoid. Third, it should have low ad be convenient and easy to understand.

   Greece's tax policy cannot be thought of as a 'good tax' because it has affected the it is clearly not enforceable because tax evasion is pervasive in the Greek economy. consequences in that it has discouraged economic activity and incentivised compan

2. A 'budget deficit' refers to a situation in which government expenditure exceeds go 'National debt', however, refers to the total amount of debt owed by a government expressed as a percentage of GDP. However, the two con are related because necessarily added to the national debt since such its n only be financed thro thought of as *compounded* budget deficit t

3. Greece's budget deficit is m t likel a mixture of structural and cyclical factors. St of a fundamental im e governmental finances. Cyclical deficits, in contrast, track th on , e.g. when an economy is in a recession, tax receipts decre increas ece's budget balance has consistently been negative from 2007 to 20 because yclical factors, e.g. the global recession. However, it is in part a structu government expenditure is interest payments on debt accumulated over time whic structural issue. Moreover, although not shown graphically, Greece has run deficits structural problems are present.

Extended-response question...

1. Policies to reduce the budget deficit are: (i) decrease government expenditure; (ii) i monetary policy to stimulate economic growth.

   Reduction in government expenditure and increases in taxation both directly impro position. When employed together these policies are called 'austerity'. However, t effects on society. It is known that government expenditure has a multiplier effect governments decrease expenditure the effect of this decrease is not one-for-one in a larger effect than the initial change. Therefore, this policy tends to shift AD inwar causing negative growth effects in the economy. Importantly, this might decrease t increase the national debt burden by decreasing GDP (as seen in the case of Greece multiplier effect of decreasing government expenditure might have a negative effe cancelling out the policy. It is also important to consider the type of expenditure th cuts could have lasting effects on the supply side of the ec y. Note, however, t independence of monetary policy it is possible to [illegible] ne negative economic ef expenditure with expansionary monetary p y.

   Likewise, increasing taxation se [illegible] impediment to economic growth, but it c income inequality, and n [illegible] nended consequences, such as tax evasion, cor disruption t ec [illegible] ivity. If an economy is in a recession, increases in taxatio Note th [illegible] eri s in direct conflict with Keynesian approaches to producing gro

   Finally, g [illegible] ments could attempt to produce economic growth in order to impro are progressive tax systems, economic growth should improve the budget deficit – t tax receipts should too increase without having to change the fundamentals of the least harmful way of reversing budget deficits. However, achieving growth is difficu Greece, where forced austerity and no control of monetary policy has left them spi Moreover, if the budget deficit is of a structural, rather than cyclical, nature then ec successful in changing the underlying causes of the deficit.

Case Study 10: 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 export [illegible] use exchange rate depreciates as fewer people choose to [illegible] po ds).

Pric
Lev
(£)

Extended-response question

1. Your answer should expl [illegible] at least two or three demand-side policies can incre one monetary pol [illegible] least one fiscal policy). You could include an AD/AS diag to the [illegible] yo drew in Question 2. You should also note some of the drawback
   - Lo [illegible] nterest rates should increase economic growth, since it increases th (as explained in Question 2). Evaluation: this is only effective up to a point (int 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 rel
   - You could also mention increasing the money supply, which has similar effects to this could lead to inflation (this is a general criticism of demand-side policies) or l
   - 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 h 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 infla
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 used
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 should
points in good detail.

Case Study 11: Ireland's housing market bubble

Data response question

1. (a) If average income is €30,000, and l... m...rage house prices are eight tim
   average price of a house in ...
   8 * 30,000 = €240,0...
   (Since in Q4 ... index = 100)
   (b) In ...7, the index of 166.2 shows house prices are 66.2% higher than the b
   20... ...d 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 upwa
   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).

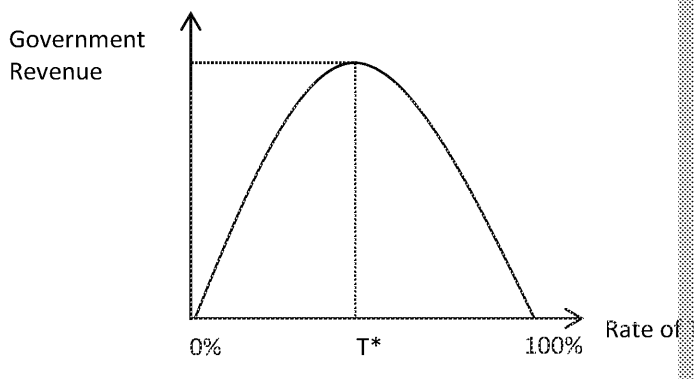
Test your knowledge

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. (a) A 'budget deficit' is a budget position in which government revenue, e.g. from
   expenditure. It is unfavourable for a government to be spending more than it
   increase the size of government debt.

   (b) Ireland's fiscal policy consisted of increasing government spending and reduci
   budget = tax revenues – government expenditure, this should lead to a budget
   you can make arguments that in the long term lower taxes lead to higher tax r
   Laffer curve) but this depends on the situation). 1 mark for identifying fiscal p
   they lead to a deficit.

3. Primarily, the relationship between the tax rate and a gover...nt's tax revenue is g
   curve is an upside-down U-shaped curve that sugges... is ...n optimal rate of tax
   government revenue. It might seem plausible ha... in...sing the rate of taxation alw
   However, at higher rates of taxation ...e ...ly to be less incentive to supply effo
   tax. (Note, an easy way of v... isin... t...is relationship is by imagining a 100% tax rat
   would exert any effo... h... sc... e government's revenue would be zero. Likewise, a
   revenu... l a... zero. Therefore, the optimal rate of tax is somewhere in betw



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 enhan 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 t or oversee the industry to some degree. On an AD/AS diagram, you could potentiall AS (during the boom) following by a fall in AS (during the recession) – this is not req conclusion should mention that the effectiveness of deregulation depends on the d the industry to start with.

Case Study 12: Supply-side policies – pri[illegible]io[illegible] the UK

Use the data

1. The index shows about 2[illegible]ed to 100, so labour productivity is twice as high

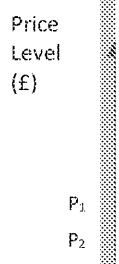
2. Figure [illegible] a [illegible]all in government spending, which is exactly what you woul privatis[illegible]since the government is no longer funding these industries). The fall to do wit[illegible]his, or perhaps to do with the tax cuts under the Conservative governm

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.



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 than long-run economic 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[illegible] on the demand side

Case Study 13: Productivity – the [illegible]-run growth?

Use the data

1. (a) Austr[illegible]
   (b) Fi[illegible]
   (c) Ca[illegible]ut – 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% acce

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 potential growth). This could be illustrated using a diagram – it may also be helpful to explain how better education increases productivity.
   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 is better educated, it may be harder for people to find jobs; su skilled jobs increases
   - Lon lag between starting the policy and seeing results: politicians may no

Case Study 14: Policy conflicts – inflation and unemployment

Use the data

1. 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 prob

2. (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. Inflation targeting refers to a monetary policy regime in which the central bank con achieve an explicit target rate of inflation (1).

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

3. The main other policy conflicts are: economic growth and inflation, economic growt 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 % then it would proba unemployment to bring down inflation. Similarly ma ery low and stable inflati cause serious problems for the econom g more of a balance is preferable.

   As part of your answer you should discuss some of the costs of inflation and unempl inflation is actually considered good if it is stable and low (the Bank of England targe unempl t should be focused on slightly more than inflation, since the effects o univers ative.

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

Case Study 15: China and exchange rate management

Use the data...

1. From Figure 1, students are likely to estimate that Chinese exports-to-GDP is about
   37.5% of $2,752.68 billion is $1,032.26 billion – *0.375 × 2,752.68 = 1032.255*

2. Chinese exports fell from 2006 to 2008 because the Chinese government allowed th
   foreign exchange markets. Instantly the currency *appreciated* from its pegged level
   have become more expensive relative to other international competitors. Naturally
   exports increases, consumption shifts to cheaper alternatives. Another factor is tha
   the 2008 global recession. Thus, as incomes fall internationally there will be less de

3. 2005's USD/CNY exchange rate is approximately 1 USD to 8.25 Chinese yuan. In 20
   1 USD to 6.25 Chinese yuan. Therefore, the percentage change in the price of the C

$$\%\ Change = \frac{6.25 - 8.25}{8.25} \times 100 = -24.24$$

   This is an *appreciation* in the Chinese y[uan] relative to the USD – this is because it no
   purchase a single USD than before. Inversely a *depreciation* of the USD against
   a USD can now purchase [more] than before.)

Test your kn[owledge]...

1. Absolute advantage refers to the ability of a country to produce something more co
   resources) than another country. Note, it is possible for a country to *not* have an ab
   of anything. Comparative advantage, in contrast, refers to the ability of a country to
   efficiently than another. Comparative advantage is concerned with production at lo

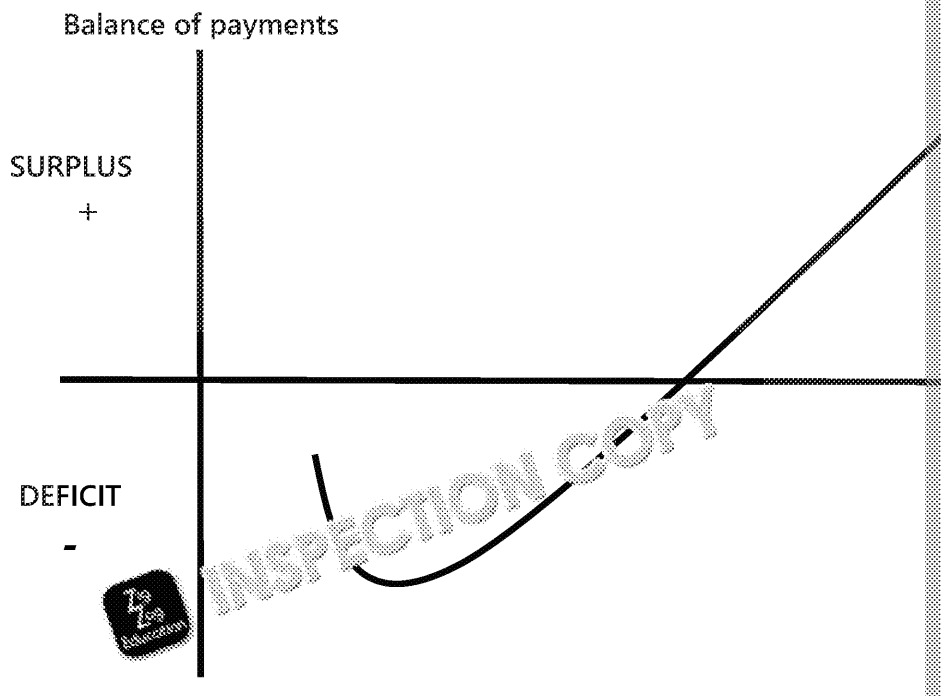
2. (a) Terms of trade is the ratio of a country's price of exports relative to its price of
   formula:

$$Terms\ of\ trade\ (TOT) = \frac{Index\ of\ export\ prices}{Index\ of\ import\ prices} \times$$

   (b) Export prices increased by 2%. Import prices decreased by 6%. Therefore, the
   (1.02)/(0.94) = 1.085, or an 8.5% increase. This amounts to an improvement in
   unit of exports, a country can import more than before.

3. Floating exchange rates are exchange rates determined by the forces of demand and
   exchange markets. Fixed exchange rates, by contrast, are exchange rates that are a
   government or central bank, and maintained through buying and selling of foreign e
   stability at the pegged rate.

4. When a country *depreciates* (floating exchange rates) or *devalues* (fixed exchange ra
   suggests that there should be an improvement in the current account balance, *ceteri*
   country's exports now appear more price-competitive in international markets, while
   expensive. However, the J-curve effect suggests that the current account might wors
   devalues. It might be the case that imports are fairly inelastic in the short run, e.g. be
   obligations to import a certain quantity, or because there are currently no suitable d
   true that exports are inelastic, e.g. if producers are unable to meet increases in dom
   lack of spare capacity. Therefore, in the short run a fall in the value of domestic curr
   balance because the value of pre-contracted and [immediately] imports increases while
   exports. Essentially, there is a time lag before [depreciation] is able to have the desi
   account. However, as domestic [producers] expands to meet increases in foreign de
   that consumption can shift [towards] domestic production, the current account improves. A
   might not see the [depreciation] as permanent, and so initially they will not change th
   This is [illustrated] on the J-curve diagram. Time is measure on the x-axis, the curre
   Initially, [the] economy is running a current account deficit. The currency devalues a
   worsening of the current account deficit – this is represented by the bottom half of
   and consumption become more flexible the current account improves, until the eco



Extended-response question

1. Costs
   - Chinese currency manipulation can cause current account imbalances in the US b Chinese and American products. Chinese producers already have a cost advanta labour-abundant and has developed efficient production methods. However, ma undervalued further disadvantages American producers. Chinese products are th current account deficit in the US – that is, there are imbalances in international tr aspirational students might research how exactly the US trade balance has chang
   - Another consideration is that an undervalued Chinese currency has imported economy to the US. This is related to the preceding point. Primarily, US firms international markets because of Chinese competition, which reduces the num export-orientated production. Second, Chinese competition also harms dome domestic consumers because Chinese imports are relatively inexpensive. Nat of US workers needed for production.
   - The US has become debt-dependent on China. In order to manipulate currenc assets. China has purchased a large number of US treasury bonds in order to because US bonds needs to be purchased in US dollars, so China purchases do effectively increasing international demand for dollars while oversupplying yu currency relatively low. The US now owes China payment of these bonds.

   Benefits:
   - Obviously, the biggest benefit to the US of an undervalued Chinese currency is to purchase cheap Chinese products in abundance. First, this has benefits in t wealthier – that is, consumers feel that they have a high purchasing power, Second, this benefits the domestic US economy b p ng input prices down effects of cost-push inflation.
   - Moreover, because the Chinese g nt must purchase US financial asset currency, the US has bee t p its interest rate low. The US governme cost. (However, a counterpoint is that these low interest rates mi 200 e through excessive borrowing.)

Case Study 1: 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. The 'balance of payments' is a record of transactions between agents of one countr includes the *current account*, *capital account* and *financial account* (1). The current in goods and services. The financial account refers to financial transactions, e.g. inv includes physical capital transactions, e.g. FDI (1).

2. (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. greate cost of imports, 1 mark for worsening of current account balance.

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

Extended-response question

1. The main benefit of th s a y is that it should boost the amount of exports from (ceteris s). ategy is likely to be more successful if it focuses on an indu well in. answer should explain this clearly, before discussing some of the po
   - Opp unity cost involved
   - Possible x-inefficiency (from micro-problems with subsidies reducing the efficie
   - 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 cost

   Other evaluation points you could mention include: success depends on the world d 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 17: 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.g oil/energy prices, slow wage growth, strong exchange rate (which leads to low import

2. (a) An increase in the interest rate would be expect pp eciate (strengthen) because it becomes more attractive to s ve n ds (1).
   (b) An appreciation of the exchan te d be expected to reduce exports (1). It would also be expe to in ase imports (1), since the purchasing power effect of this is e g of trade balance (or widening of the trade deficit) m th 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 variab
   - 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