



## **Economics Questions By Topic:**

### **National Income (2.4)**

### **A-Level Edexcel Theme 2**

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**SECTION A**

**Write your answers in the spaces provided.**

- 1** After the Global Financial Crisis of 2008, the US President introduced expansionary fiscal policies of \$800 billion. The International Monetary Fund estimated that the multiplier at the time was approximately 1.5.

(Source adapted from: <https://www.economist.com/the-economist-explains/2016/09/07/what-is-the-keynesian-multiplier>)

- (a) Which **one** of the following is a withdrawal from the circular flow of income? (1)

- A** Exports
- B** Government spending
- C** Investment
- D** Taxation

- (b) Calculate the total final increase in US aggregate demand as a result of the President's 'expansionary fiscal policies', assuming no other changes. (2)

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**(Total for Question 1 = 3 marks)**

2 The planned investment in the redevelopment of Dover Port will cost £115 million. The Chief Executive said it will lead to many 'new job opportunities for local people and a transformed waterfront experience' with new cafés, bars, and shops.

(Source adapted from: <https://www.kentonline.co.uk/dover/news/docklands-redevelopment-work-to-start-118581/>)

(a) If the value of the multiplier is 1.8, which **one** of the following will be the total increase in GDP from the redevelopment, assuming other things are equal? (1)

- A £64 million
- B £115 million
- C £207 million
- D £230 million

(b) Using the example above, explain how the multiplier process leads to an increase in aggregate demand. (4)

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**(Total for Question 2 = 5 marks)**

**3** It is estimated that building a second runway at Gatwick airport will require an investment of £9.3 billion.

The total increase in UK GDP as a result of this injection is expected to be around £44.1 billion.

(Source: adapted from [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/452267/AC01\\_tagged\\_amend\\_25\\_11.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/452267/AC01_tagged_amend_25_11.pdf) © Crown Copyright)

(a) Define the term 'injection' in this context.

(1)

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(b) Calculate the value of the multiplier based on the data given. You are advised to show your working.

(2)

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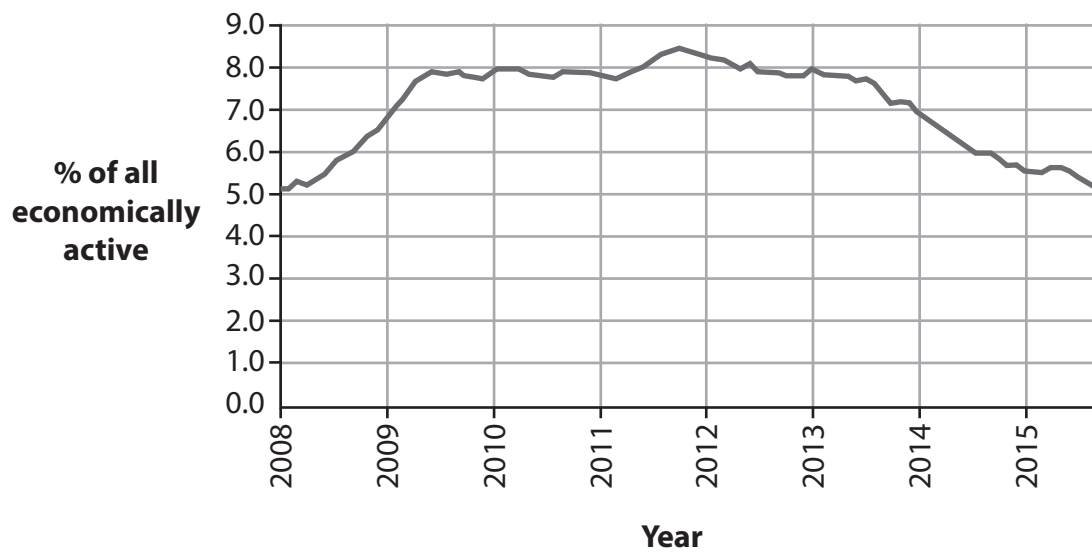
(c) Which **one** of the following is a likely cause of a decrease in the value of the UK's multiplier?

(1)

- A** A decrease in the marginal propensity to save
- B** A decrease in the marginal propensity to tax
- C** An increase in the marginal propensity to consume
- D** An increase in the marginal propensity to import

**(Total for Question 3 = 4 marks)**

4 The chart below shows the UK unemployment rate, seasonally adjusted, from 2008 to 2015



(Source: <http://www.ons.gov.uk/ons/rel/lms/labour-market-statistics/december-2015/statistical-bulletin.html#tab-8--Unemployment>)

Explain the likely effects on the circular flow of income of the change in unemployment between 2013 and 2015.

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(Total for Question 4 = 4 marks)

5 The table below shows marginal propensity to save data for an economy.

Year	Marginal propensity to save (mps)
2010	0.11
2011	0.09
2012	0.07
2013	0.05
2014	0.05
2015	0.04

(a) Explain **one** possible reason for the changes in the marginal propensity to save as shown in the table.

(2)

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(b) Explain the likely effect of a fall in the marginal propensity to save on the value of the multiplier if other things remain equal.

(2)

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An economy has marginal propensity to save of 0.1, marginal propensity to tax of 0.2 and marginal propensity to import of 0.1.

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

(1)

- A** 0.4
- B** 0.6
- C** 1.7
- D** 2.5

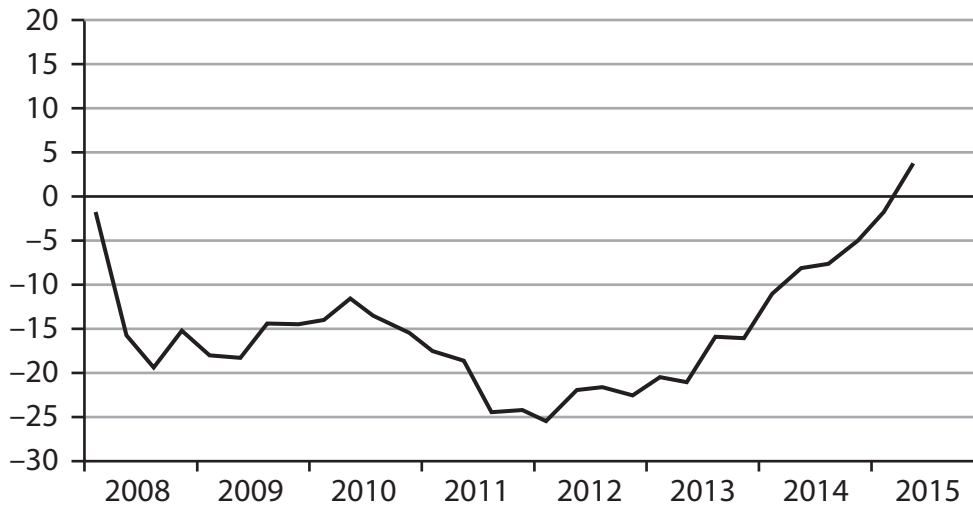
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**(Total for Question 5 = 5 marks)**



- 6 The chart below shows the results from a survey of UK consumers' confidence in their financial situation. A negative balance means that, on average, consumers reported their financial situation got worse, a positive balance means they reported it improved and a zero balance indicates no change. This is recorded on a scale from -100 to +100.

**UK consumer confidence**



(Source: [http://www.ons.gov.uk/ons/dcp171778\\_418064.pdf](http://www.ons.gov.uk/ons/dcp171778_418064.pdf))

Which **one** of the following is most likely to result from an improvement in UK consumer confidence? A decrease in the marginal propensity to:

(1)

- A consume
- B tax
- C import
- D save

(Total for Question 6 = 1 mark)

7 (a) Define the term 'national income'.

(1)

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(b) Which **one** of the following is an injection into the circular flow of income?

(1)

- A** Taxation
- B** Imports
- C** Investment
- D** Saving

(c) Define the term 'circular flow of income'.

(2)

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**(Total for Question 7 = 4 marks)**

**8** In 2014 the Bank of England estimated the marginal propensity to consume of UK consumers to be 0.5.

In 2014 the Chancellor of the Exchequer announced a £15 billion investment programme into UK road infrastructure.

(Sources: <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q405.pdf> and <https://www.gov.uk/government/news/autumn-statement-2014-16-things-you-should-know>)

Using the information above, calculate the total increase in national income, resulting from the £15 billion investment.

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**(Total for Question 8 = 3 marks)**

**END OF SECTION A**

**SECTION B**

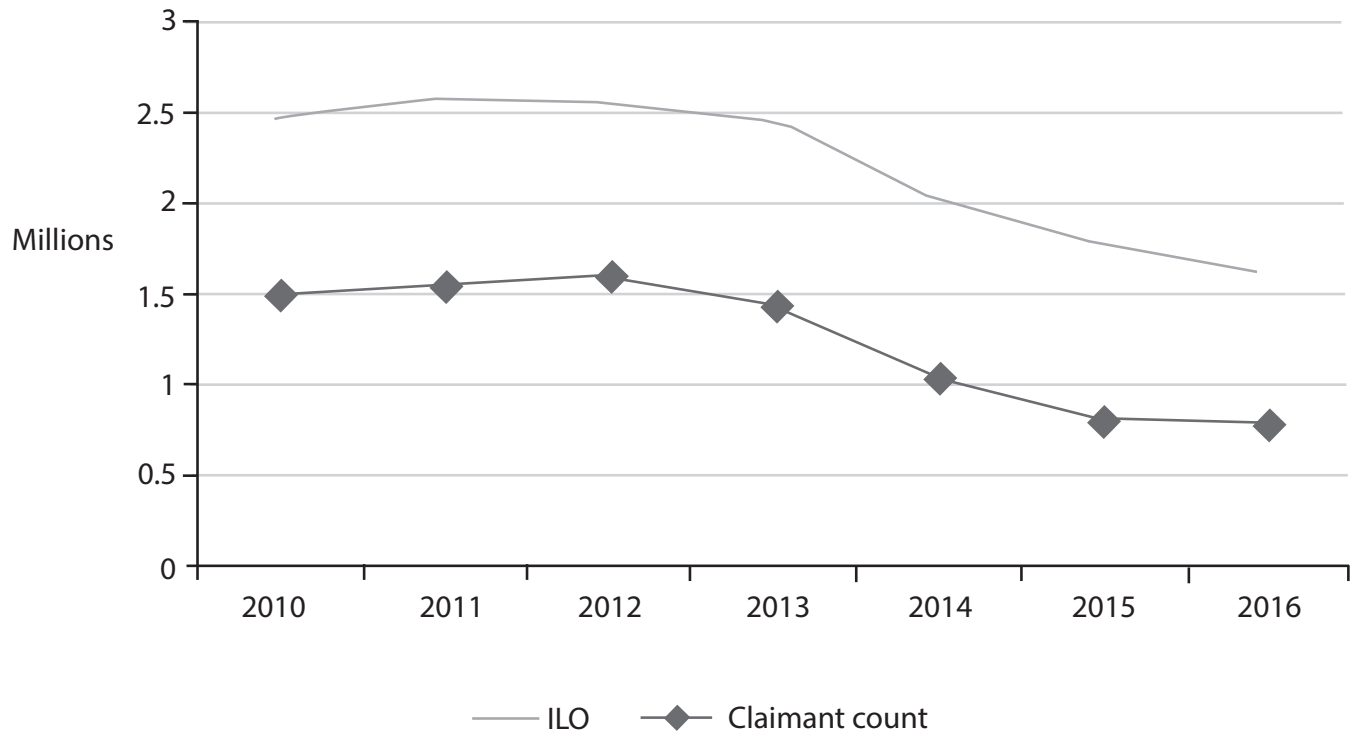
**Read all extracts/figures before answering.**

**Write your answers in the spaces provided.**

**Question 9**

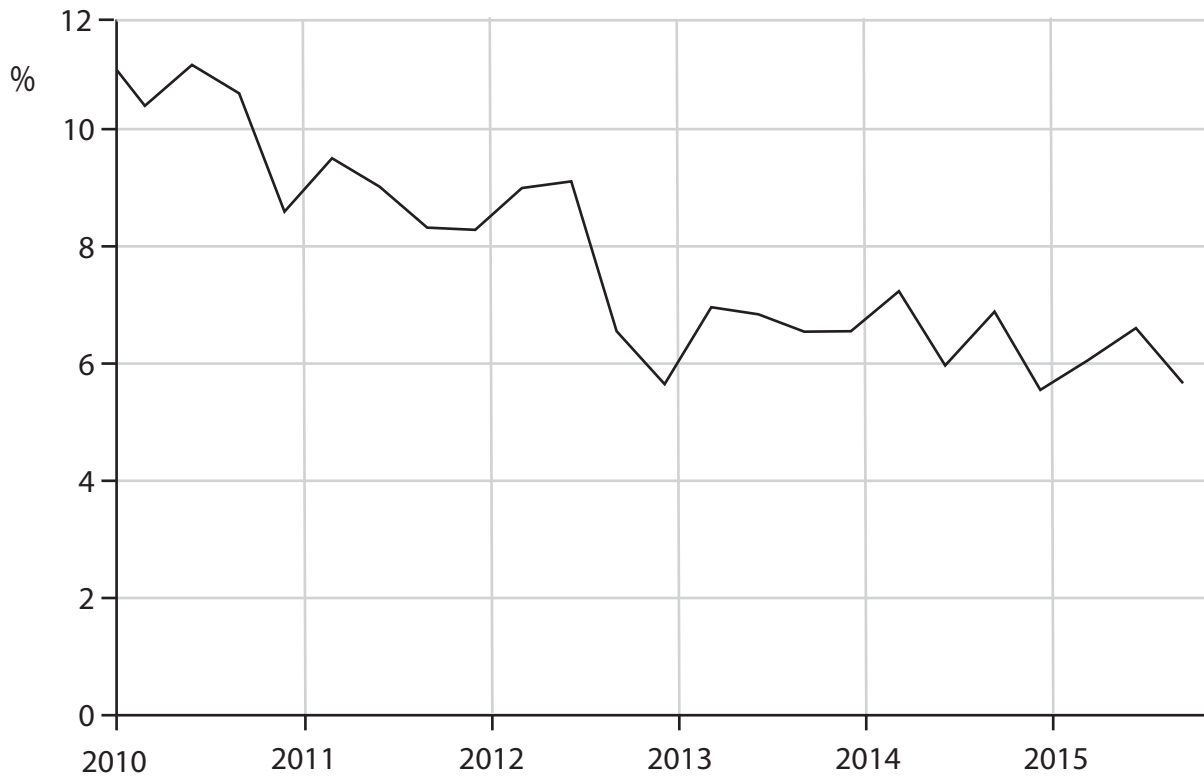
**The UK economy**

**Figure 1: Unemployment – International Labour Organisation (ILO) and the claimant count, millions, 2010-2016**



(Source: ONS Datasets, <https://www.ons.gov.uk/>)

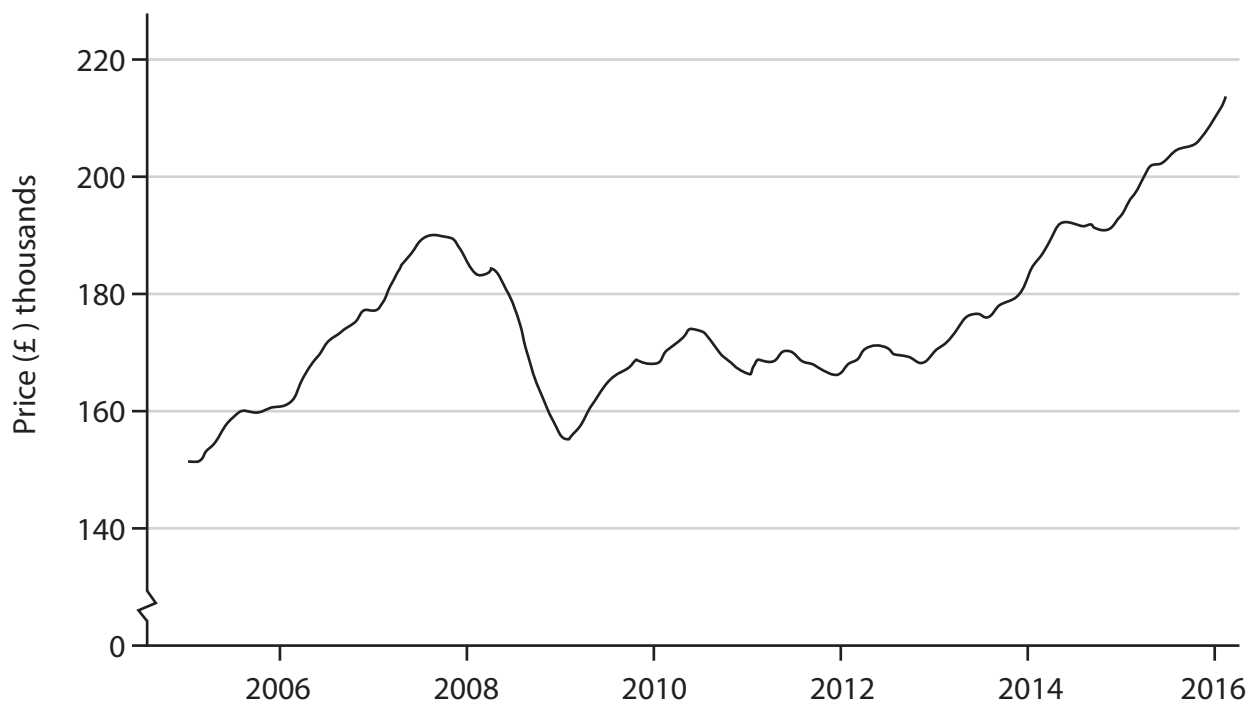
**Figure 2: Household savings\*, 2010-2015**



\* Savings as a percentage of household disposable income

(Source: <http://www.tradingeconomics.com/united-kingdom/personal-savings>)

**Figure 3: UK average house prices, 2005-2016**



(Source: <http://www.telegraph.co.uk/property/house-prices/the-state-of-the-uk-housing-market-in-five-charts/>)

## Extract A

### Soaring house prices

House prices are still rising rapidly. The average UK house price was £214 000 in June 2016, according to the Office for National Statistics (ONS). This is £24 000 more than it was at its peak in September 2007, just before the economic downturn. First-time buyers have experienced the largest rise in house prices.

5

Even the loss of consumer confidence over Britain's vote to leave the EU did not stop house prices from rising – annual growth increased from 5.2% in July 2016 to 5.6% in August 2016. House price growth was the strongest in London, with annual average prices rising by 9.6%. However, in Wales average house prices actually fell by 0.5% during the same period. In its first post-Brexit referendum forecast, estate agency Countrywide said that house prices will fall by 1% across the UK in 2017, before rising by 2% in 2018.

10

Real household income in the UK fell by 10.4% in the years following the financial crisis. This increased the difference between real income and house prices. In 1997, a house cost little more than twice the average income. By early 2015, the average price of a house was five times the average annual income.

15

The rate of home ownership for 25 to 34-year-olds has fallen to 35.8% over the last twenty-five years as houses became less affordable. First-time buyers have to wait longer to save up for a house deposit. Conversely, home ownership has risen to 78.6% among those aged 65 to 74.

(Source: adapted from 'The state of the UK housing market in five charts', The Telegraph, <http://www.telegraph.co.uk/property/house-prices/the-state-of-the-uk-housing-market-in-five-charts/>; 'UK house price growth slows as demand cools after Brexit vote', The Guardian, <https://www.theguardian.com/business/2016/sep/30/uk-house-price-growth-slows-demand-cools-brexit-vote-nationwide>)

## Extract B

### UK migration trends in the year ending June 2016

Inward migration levels are among the highest ever recorded with an estimated 650 000 people moving to the UK. This is an increase of around 11 000 from the previous year.

Employment remains the most common reason for long-term migration (312 000) to the UK, with around 182 000 of these coming with a definite job and 130 000 looking for work.

5

Long-term migration to the UK for study was estimated to be 163 000. In addition, 80 000 long-term migrants arrived in the UK to accompany their families. There were 41 280 refugees applying for asylum, including dependants, of which 10 547 people were granted asylum. Asylum applicants cannot usually accept offers of employment while their case is being processed.

10

(Source: adapted from 'Migration Statistics Quarterly Report: December 2016', ONS, <https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/bulletins/migrationstatisticsquarterlyreport/dec2016>)

9 Explain **two** factors that might cause a rise in the value of the multiplier.

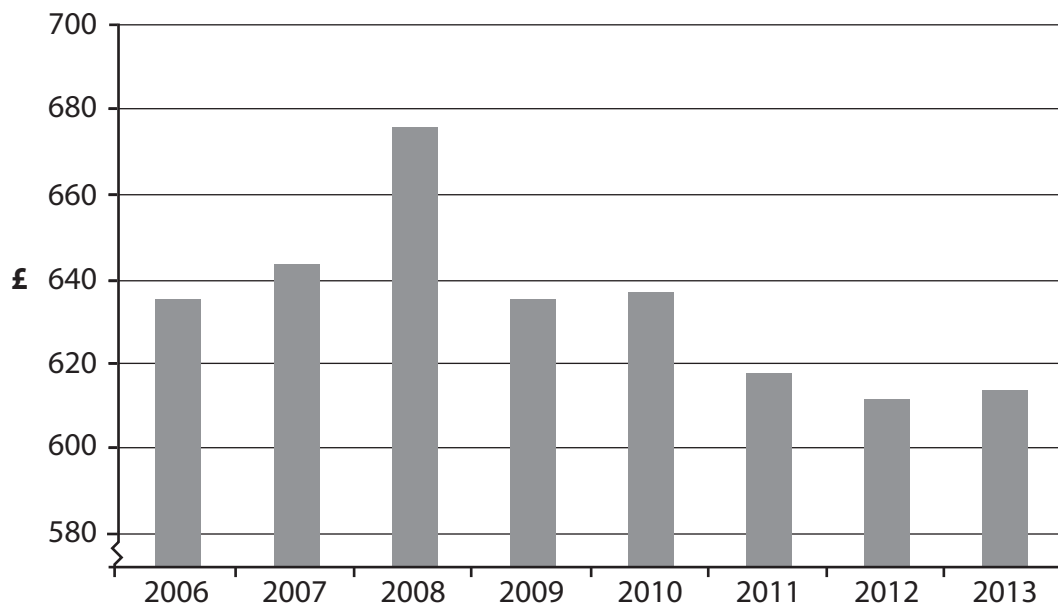
(6)

(Total for Question 9 = 6 marks)

## Question 10

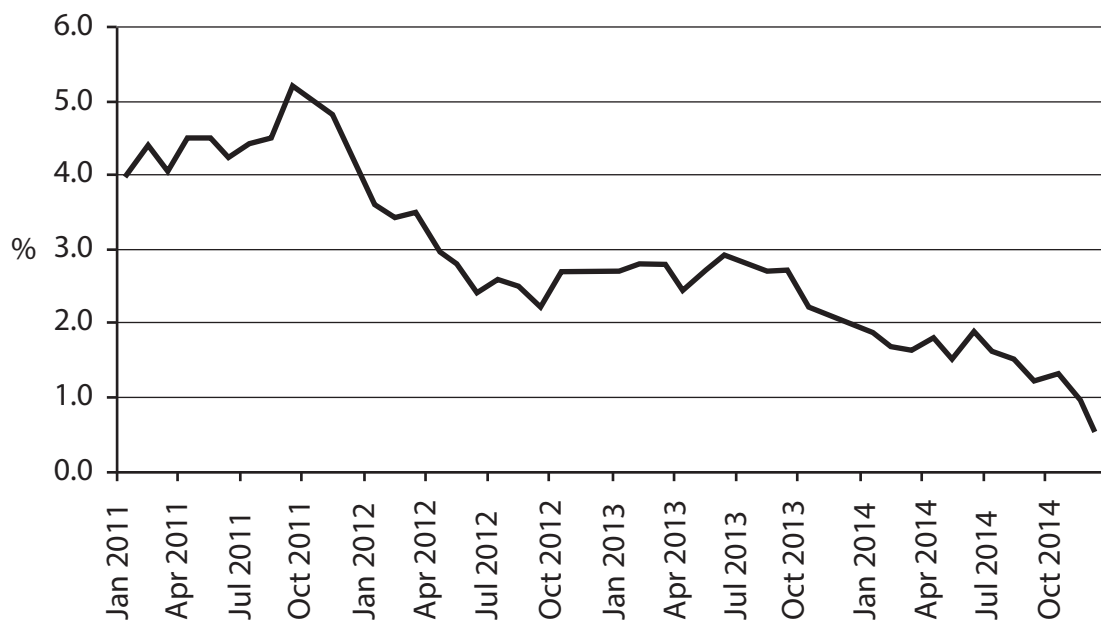
### UK incomes, inflation and monetary policy

Figure 1 – UK average weekly household real income



(Source: <http://www.ons.gov.uk/ons/rel/family-spending/family-spending/2014-edition/rft-a44-final-2013.xls>)

Figure 2 – UK inflation rate as measured by percentage changes in the Consumer Price Index (CPI)



(Source: <http://www.bankofengland.co.uk/publications/Pages/inflationreport/2015/feb.aspx>)



## Extract A

### Britons should not fear rise in interest rates

The Monetary Policy Committee (MPC) of the Bank of England is prepared to raise interest rates “in the near future” if inflation increases, one of its senior policymakers has warned.

Kristin Forbes, a member of the MPC, said a rise in borrowing costs would also be necessary should household debt reach unhealthy levels. However, she stressed that this was not yet a cause for concern. 5

With the UK’s base rate of interest at 0.5% and inflation at a record low and expected to be negative, the MPC is currently under no pressure to raise interest rates, despite Britain’s economic recovery.

UK inflation is being driven lower by the slump in global oil prices, which have roughly halved since summer 2014, and the Bank’s governor Mark Carney warned earlier this month that a strong domestic economy would translate into higher UK inflation over the medium term. “The most likely next move in monetary policy is an increase in interest rates. The message is clear,” Carney said. 10

Forbes said that “even the more lagged effects of the rise in the value of the pound will likely peak in the first part of this year and also gradually fade. Inflation will then most likely bounce back. 15

“Since interest rates take well over a year to be fully effective, they should be adjusted to respond to inflationary risks at that time horizon – when all of these effects have diminished – rather than respond to today’s inflation.”

(Source: adapted from <http://www.theguardian.com/money/2015/feb/24/britons-should-not-fear-rise-in-interest-rates-when-they-come-says-boe-member>)

## Extract B

### Deflation is bad news

The problem with deflation is that once you have it you can’t get rid of it. Central banks know what to do about inflation but they do not have the policy tools to deal with deflation when interest rates are almost as low as they can go. Just look at Japan, which had deflation in nine separate years from 1999-2012, with two additional years at zero, averaging minus 0.3%. The highest in any single year was minus 1.3% in 2013. 5

In the European Union (EU) in 2008, at the start of the financial crisis, there were fears of deflation but at that time central banks had the ability to cut interest rates by nearly 5 percentage points. Those fears may now be coming true, with the EU experiencing deflation of 0.5% in 2015.

This was driven primarily by declines in energy prices, but there was also deflation in non-energy industrial goods and telecommunications. The collapse in the cost of shipping goods potentially suggests something deeper is going on and may lead to a more persistent form of deflation than Mark Carney has currently claimed. 10

(Source: adapted from <http://www.independent.co.uk/news/business/comment/david-blanchflower/david-blanchflower-deflation-is-bad-news--and-britain-is-likely-to-be-next-to-get-it-10078832.html>)

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

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(b) Assess the likely impact of falling real incomes on UK consumers.

(10)

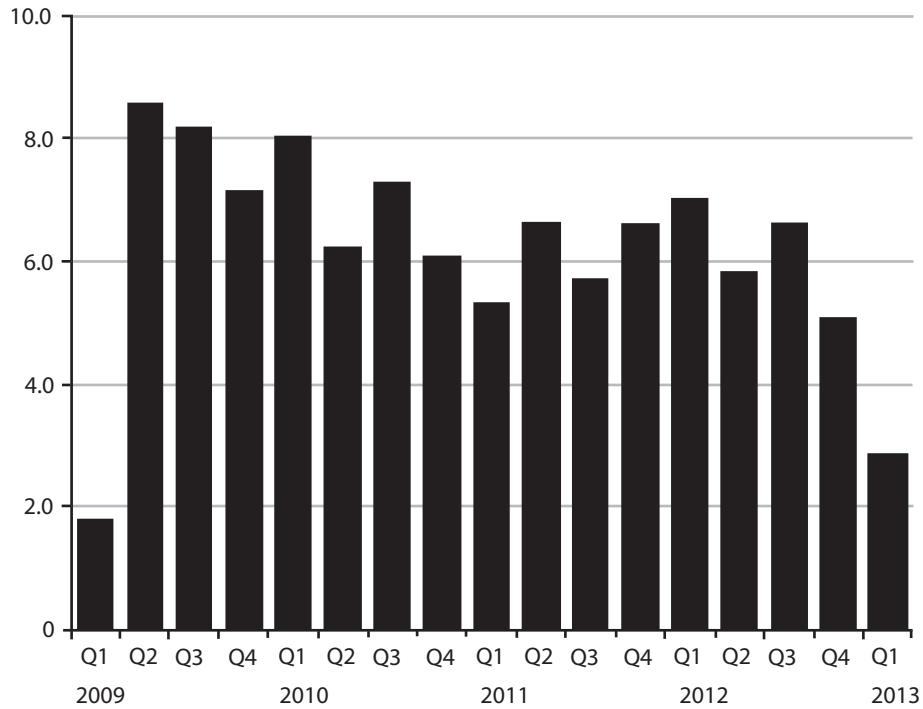
A series of horizontal dotted lines for writing the answer.

A large rectangular area with rounded corners, containing 25 horizontal dotted lines for writing.

(Total for Question 10 = 14 marks)

## 11 Savings, GDP, housing market and monetary

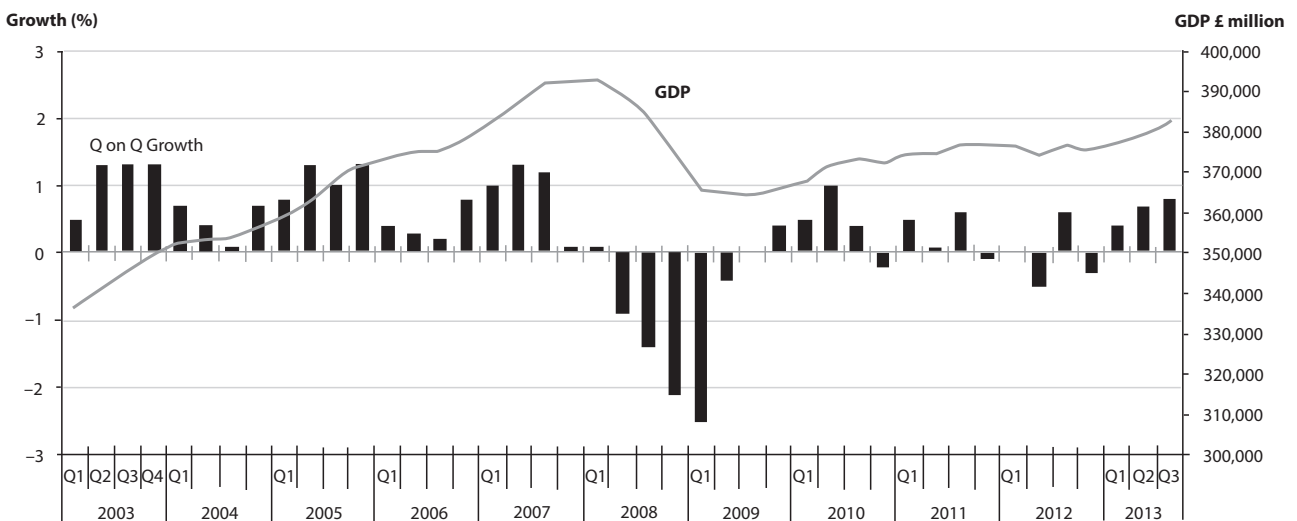
policy Figure 1 UK household savings ratio\*



\*Savings as a percentage of household disposable income

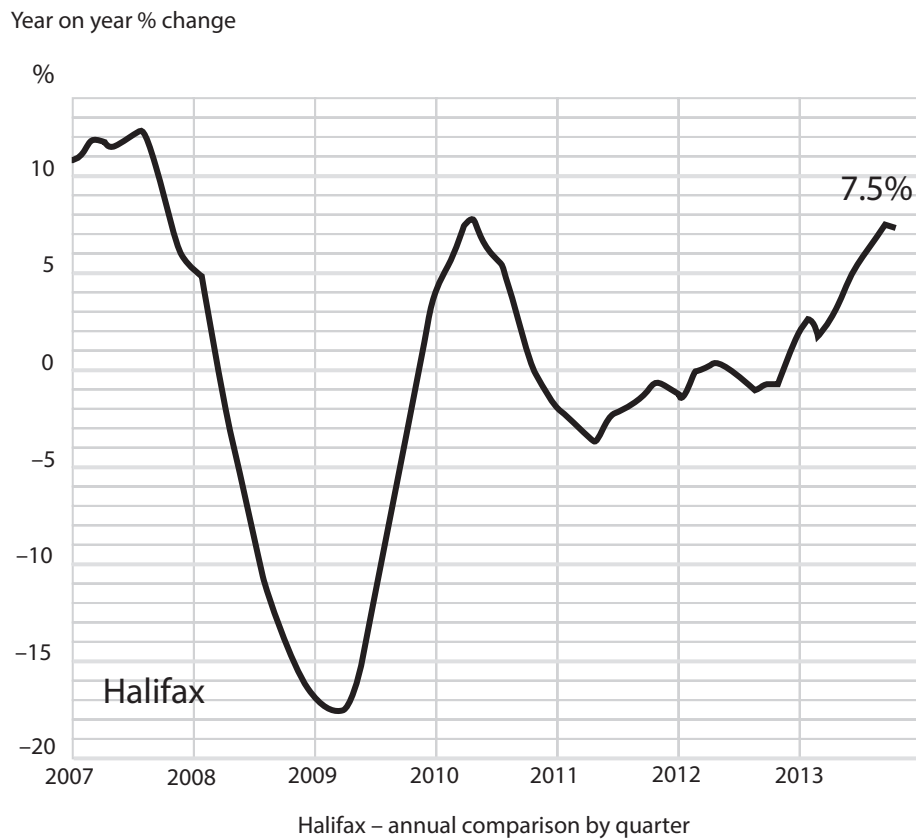
(Source: <http://www.ons.gov.uk/ons/publications/re-referencetables.html?edition=tcm%3A77-324888>)

Figure 2 UK GDP and GDP growth (quarter on quarter)



(Source: [http://www.ons.gov.uk/ons/resources/figure3\\_tcm77-332895.png](http://www.ons.gov.uk/ons/resources/figure3_tcm77-332895.png))

**Figure 3 Percentage annual change in UK house prices**



(Source: Halifax)

### **Extract 1 House prices and the government's Help-to-Buy Scheme**

The UK house price index from the Royal Institute of Chartered Surveyors showed that in September 2013 British house prices rose at their fastest monthly rate in 11 years and sales hit a four-year high. Both measures pointed to a sustained recovery in the property market. Prices rose in all regions except the north-east of England, and respondents now expect prices to grow by 2.6% in the next 12 months. Concerns have been expressed that a housing price bubble could threaten financial stability.

5

(Sources: adapted from <http://uk.reuters.com/article/2013/10/07/uk-house-prices-idUKBRE9960YL20131007> and

[http://www.lse.co.uk/AllNews.asp?code=kkj6mz7d&headline=MARKET\\_COMMENT\\_UK\\_House\\_Prices\\_Continue\\_To\\_Rise\\_As\\_US\\_Government\\_Remains\\_Shut](http://www.lse.co.uk/AllNews.asp?code=kkj6mz7d&headline=MARKET_COMMENT_UK_House_Prices_Continue_To_Rise_As_US_Government_Remains_Shut))

## Extract 2 UK monetary policy

Since 1997, the focus of the Bank of England's Monetary Policy Committee had been to maintain a low and stable inflation rate. However, the financial crisis forced a change in priorities.

The Governor of the Bank of England, Sir Mervyn King, stood down after holding the post for 10 years between 2003–2013. Amongst other things his governorship was marked by two major policy decisions. 5

Firstly, he encouraged a highly expansionary monetary policy. Interest rates traditionally moved in quarter-point changes, but once the full extent of the financial crisis was plain, Sir Mervyn persuaded the Monetary Policy Committee to cut rates by 1.5 percentage points in November 2008 and further big reductions over the following months. By March 2009, interest rates had been cut to 0.5% and remain at this level. In the same month, the Bank of England began to inject money into the economy through quantitative easing in a bid to reflate the economy. Normalising monetary policy will take many years. 10

Secondly, Sir Mervyn publicly supported rapid fiscal consolidation, a policy of reducing the budget deficit as quickly as possible, in order to reduce the national debt. His comments were used by the Coalition Government to justify its decision to accelerate the budget deficit reduction programme. 15

(Source: adapted from <http://www.ft.com/cms/s/0/e2fb7570-dfea-11e2-bf9d-00144feab7de.html#ixzz2hRoUSZMD> June 29 2013)



**11** Explain the likely impact of a government budget deficit on the circular flow of income.

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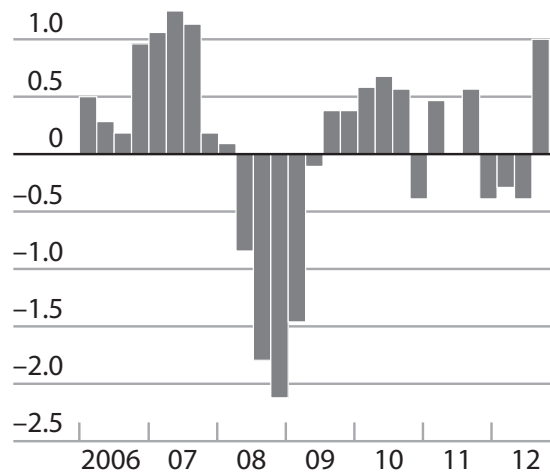
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**(Total for Question 11 = 6 marks)**

## 12 Growth, Productivity and Unemployment

**Figure 1**  
**UK Growth, percentage change in real GDP from previous quarter**



### **Extract 1** **Exceptional effects on growth**

The 1% growth rate in real GDP in the third quarter of 2012 from the previous quarter was the strongest in five years. However, the economy is still no bigger than it was a year ago, and is 3% smaller than it was before the financial crisis hit in 2008. One-off factors such as the Queen's Diamond Jubilee and the London Olympics also improved the third quarter figure, which was better than the 0.6% economists predicted.

5

But few believed the better data signalled the start of a strong economic recovery. Employment is rising, real disposable incomes are recovering and retail sales are picking up. However, the global economy is slowing, the government plans to reduce its budget deficit further next year and confidence among businesses and households remains fragile.

10

(Source for Figure 1 and Extract 1: © The Financial Times Ltd 2013)

### **Extract 2** **UK unemployment and employment**

UK ILO unemployment is at 2.51 million, up 55% since 2007, a similar increase to the US and the eurozone, according to the OECD. That eurozone average disguises huge variations, however, from rises of well over 100% in Greece and Spain to a fall of 33% in Germany.

5

In past recessions, the proportion of the unemployed out of work for more than 12 months in the UK has typically increased to 40–50%. This time it has reached only 35%. This has been partly attributed to the welfare-to-work policies of current and previous governments which try to push people quickly back into whatever jobs are available.

The UK's strength in creating jobs, taking the number employed back above the pre-crisis level, has been balanced by concern about the quality of those jobs – a lot of them self-employed, part-time or temporary – and a poorer productivity performance than the average for developed countries.

10

(Source for Figure 1 and Extract 2: © stats.oecd.org)

**12** Using the concept of the multiplier, assess the contribution of “one-off factors such as the Queen’s Diamond Jubilee and the London Olympics” (Extract 1, lines 3 and 4) to economic growth.

**(12)**

A series of horizontal dotted lines provided for writing the answer to question 12.

(Total for Question 12 = 12 marks)

### 13 Consumption, Investment and the UK Government's Fiscal Target

#### Extract 1 Components of Aggregate Demand (Report from the Office of Budgetary Responsibility)

The real disposable income of UK households is forecast to have fallen by 2.3% in 2011, a post-war record. Earnings growth is not expected to overtake inflation again until 2013 and not by a significant margin until 2014. As a result, we expect consumer spending to remain broadly constant in real terms in 2012 before picking up as real household disposable income starts growing again.

5

We expect private sector employment to rise by around 1.7 million between the start of 2011 and the start of 2017, but this will be partly offset by a fall of around 710,000 in general government employment. The government still aims to reduce the budget deficit rapidly in order to achieve its fiscal target.

Business investment has shown virtually no growth in 2011. The CBI's latest Quarterly Industrial Trends Survey suggests that the investment that has taken place has largely replaced worn out assets, rather than added to the capital stock.

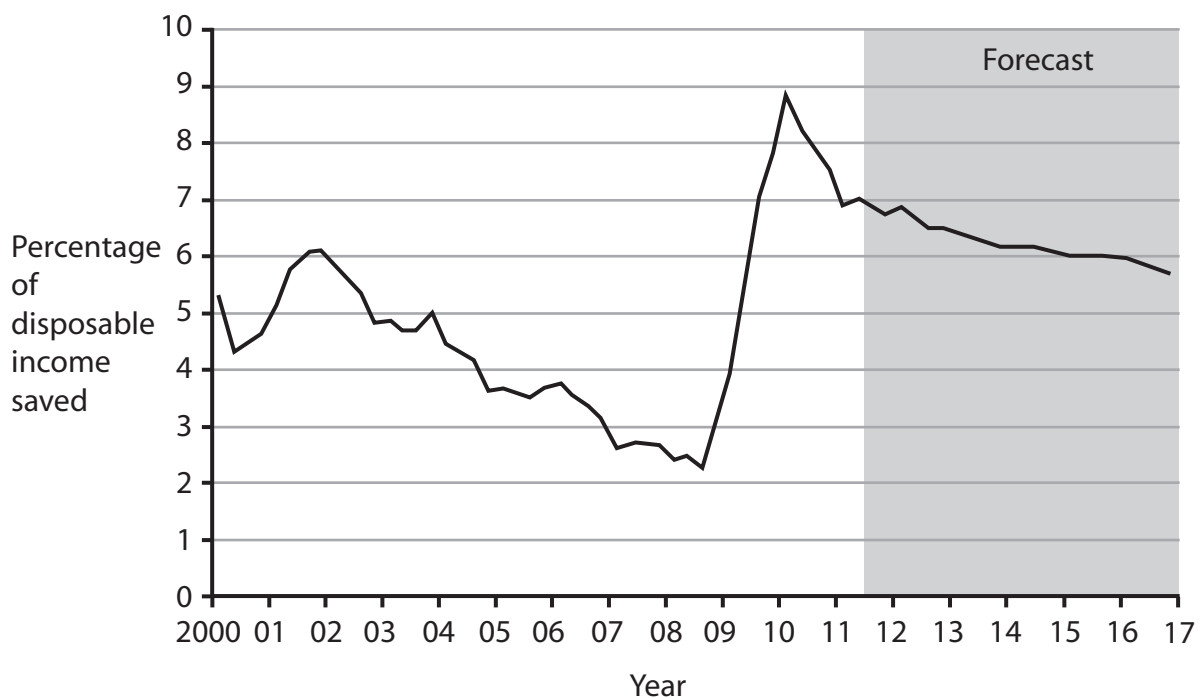
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Businesses have used some of their profits to pay back bank loans and they may also have started to build up cash reserves against further shocks as uncertainty over the outlook has risen. This might lead to a reduction in business investment in 2012. We also continue to predict a small current account deficit in the medium term.

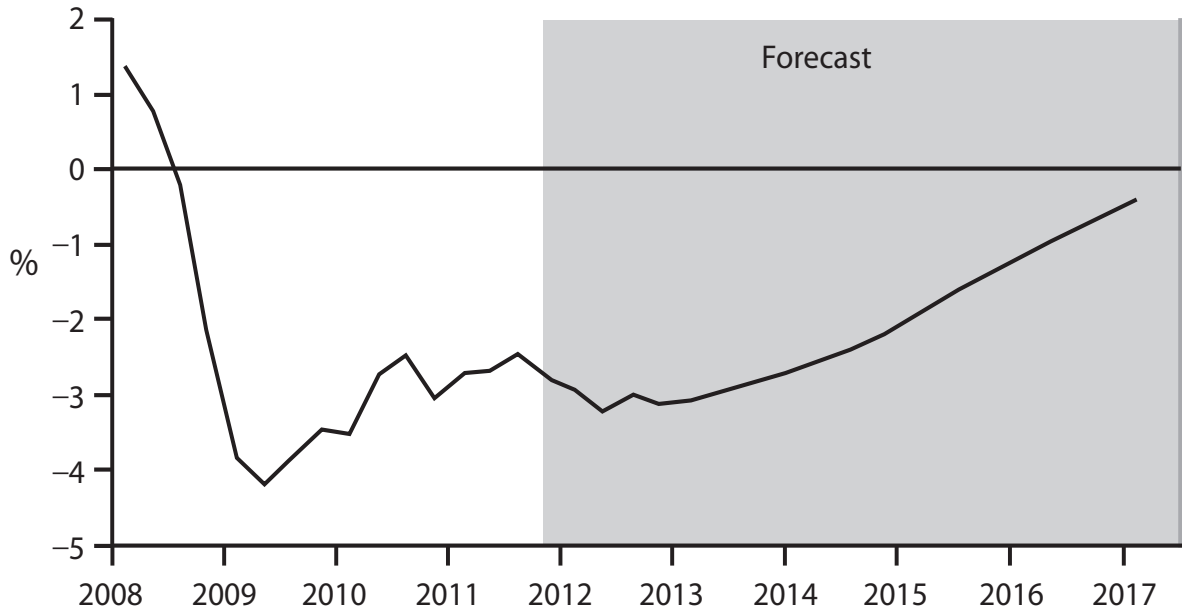
15

(Source: © Crown Copyright Office of Budgetary Responsibility Autumn Report, November 2011)

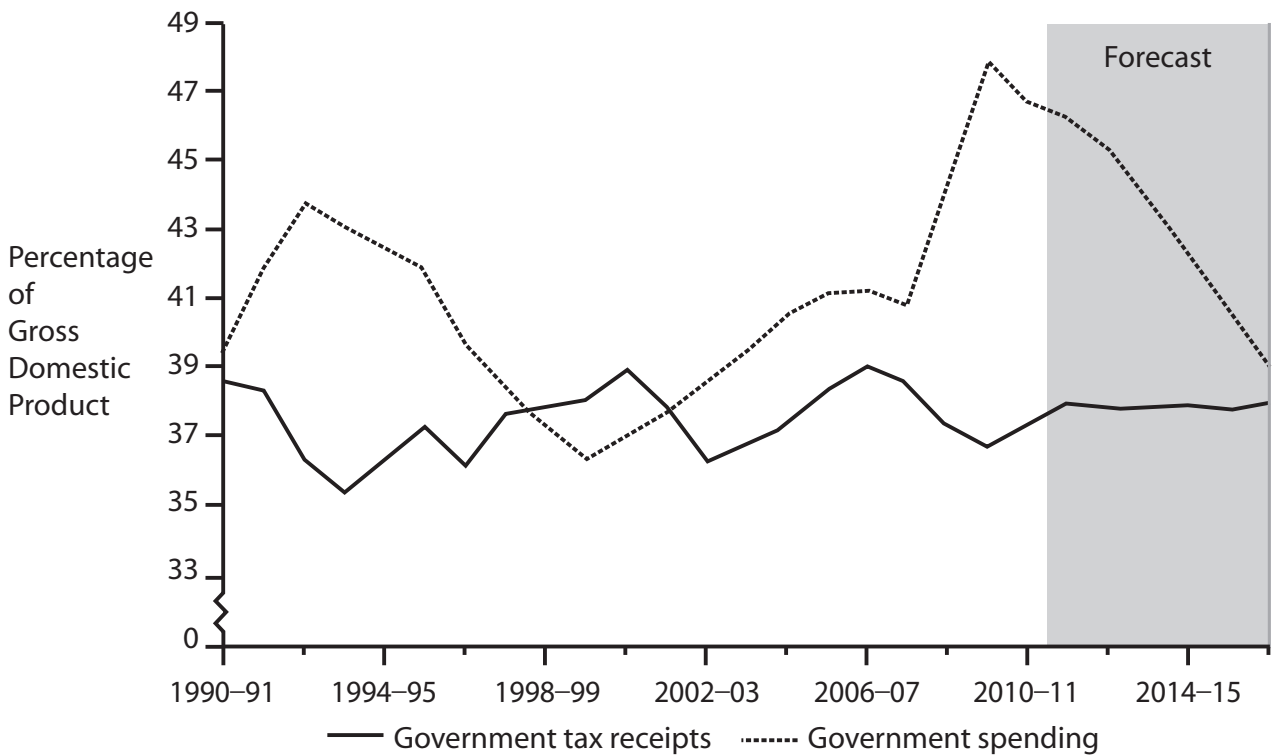
**Figure 1 UK savings ratio: percentage of UK household disposable income saved**



**Figure 2 The UK output gap**



**Figure 3 Total UK Government public spending and tax receipts**



(Source for Figures 1-3: © Crown Copyright Office of Budget Responsibility Economic and Fiscal Outlook, November 2011)

(a) With reference to Figure 1, explain how the forecast change in the savings ratio from 2010 might affect the value of the multiplier.

(8)

A series of horizontal dotted lines provided for writing the answer.

\* (b) With reference to Figure 2, discuss **two** likely consequences of the output gap from 2009.

(12)

A series of horizontal dotted lines for writing the answer.



(Total for Question 13 = 20 marks)

## 14 Real Income and Unemployment

### Extract 1 UK households' real disposable incomes

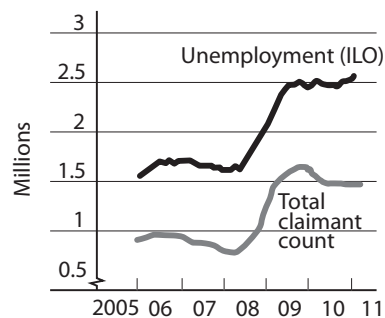
New GDP figures show real household disposable incomes falling by 0.8% in 2010. This is the first time the measure has fallen since 1981.

Nominal wage growth edged up with average earnings rising 2.3% in the year to January 2011. This annual growth rate for workers' pay was mainly driven by bonus payments in the finance and business services sector. Meanwhile, CPI inflation was 4.0% in January 2011.

5

(Source: Adapted from an article by Brian Groom from the Financial Times on 16 March 2011  
© The Financial Times Limited 2011)

### Figure 1 UK unemployment at 17-year high, millions



(Source for Figure 1: Adapted from the Financial Times on 16 March 2011  
© The Financial Times Limited 2011)

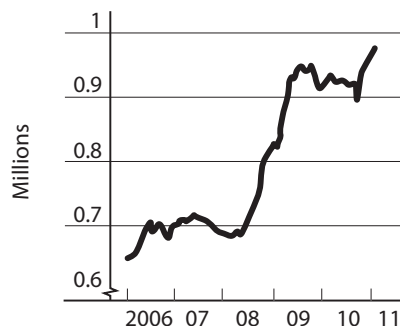
### Extract 2 Unemployment measurements diverge

The unemployment rate, as measured by the International Labour Organisation (ILO), for the three months to January 2011 was 8.0% of the economically active population. The total number of unemployed people, using the ILO measure, increased by 0.1% (27,000) over the three months to January 2011 to reach 2.53 million, the highest figure since 1994. The number of people claiming Jobseeker's Allowance (the claimant count) fell by 10,200 between January and February 2011 to reach 1.45 million.

5

(Source for Extract 2: Adapted from the Office of National Statistics 16 March 2011  
© Crown Copyright)

### Figure 2 ILO survey of youth (aged 16-24) unemployment, millions



(Source: Adapted from the Financial Times on 16 March 2011  
© The Financial Times Limited 2011)

### **Extract 3 Youth unemployment**

The ILO unemployment level for those aged from 16 to 24 reached 974,000 in the three months to January 2011, the highest figure in percentage and absolute terms since comparable records began in 1992. Chris Grayling, the employment minister, has questioned the accuracy of the ILO figure and the survey method used.

Grayling claimed that youth unemployment had fallen if young people in education were excluded from the figures. The ILO survey should make sure that full time students who cannot find a part-time job while they study are not included in this measure of unemployment.

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(Source: Adapted from © Guardian News & Media Ltd 2011, April 13 2011)

(a) With reference to Extract 1, explain the difference between real and nominal incomes.

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(b) With reference to the extracts and your own knowledge, explain **two** possible causes of falling real disposable income in the UK during 2010.

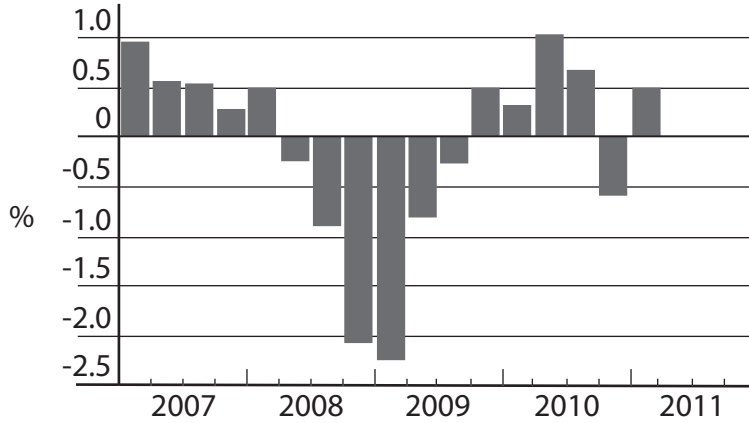
(8)

(Total for Question 14 = 12 marks)

**Question 15**

**UK Growth and the Balance of Payments**

**Figure 1 UK Real GDP growth, quarter on quarter**



Source: ONS, Thomson Reuters

(Source: Adapted from the Financial Times © The Financial Times 2011)

**Figure 2 UK Balance of Payments Current Account 2009-10 (£ billions)**

	2009	2010
Trade in goods	-82.4	-97.8
Trade in services	52.7	49.3
<b>Subtotal: Trade in goods and services</b>	<b>-29.7</b>	<b>-48.5</b>
Income (interest, profits and dividends)	20.6	31.8
Current transfers	-4.9	-19.7
<b>Total: Current account balance</b>	<b>-14.0</b>	<b>-36.4</b>
<b>Current account balance as % of GDP</b>	<b>-1.7%</b>	<b>-2.5%</b>

(Source: Adapted from the Office of National Statistics © Crown Copyright)

### **Extract 1 For many the real recession starts now**

The economy is still showing only very limited signs of the hoped-for rebalancing of aggregate demand away from debt financed consumption and government spending to investment and exports.

The government's deflationary fiscal policy will start to reduce its budget deficit. The Office for Budget Responsibility forecasts that in order to maintain their living standards, households will have to reduce their savings and increase their borrowing further. Household debt is forecast to grow from 160% of disposable income to a record 175%, or £2.1trillion, by 2015.

5

Exports are growing, but not as strongly as those of some other European countries. What is more, the 20% plus depreciation in the pound since 2008 seems to be having virtually no impact on imports. This has contributed to the UK's largest ever recorded trade in goods deficit in 2010. As the Bank of England's Monetary Policy Committee (MPC) said in minutes to its last meeting, it's possible "that domestic substitutes for some imported goods and services are not available".

10

Britain's manufacturing base is so depleted that the economy may no longer be capable of responding to gains in competitiveness. The recent decisions of the MPC to maintain a record low 0.5% base interest rate have not yet led to the hoped-for increase in business investment. Some economists now predict an early rise in this base rate to act against inflation being above the target rate.

15

(Source: Adapted from © Copyright Telegraph Media Group Limited 2011, 25th April 2011)

**15**

With reference to Figure 2, explain why the UK current account balance in 2010 was a net withdrawal from the UK's circular flow of income.

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**(Total for Question 15 = 4 marks)**



## 16 Public Sector cuts, unemployment and inflation targets

### Extract 1 Cutting back the state

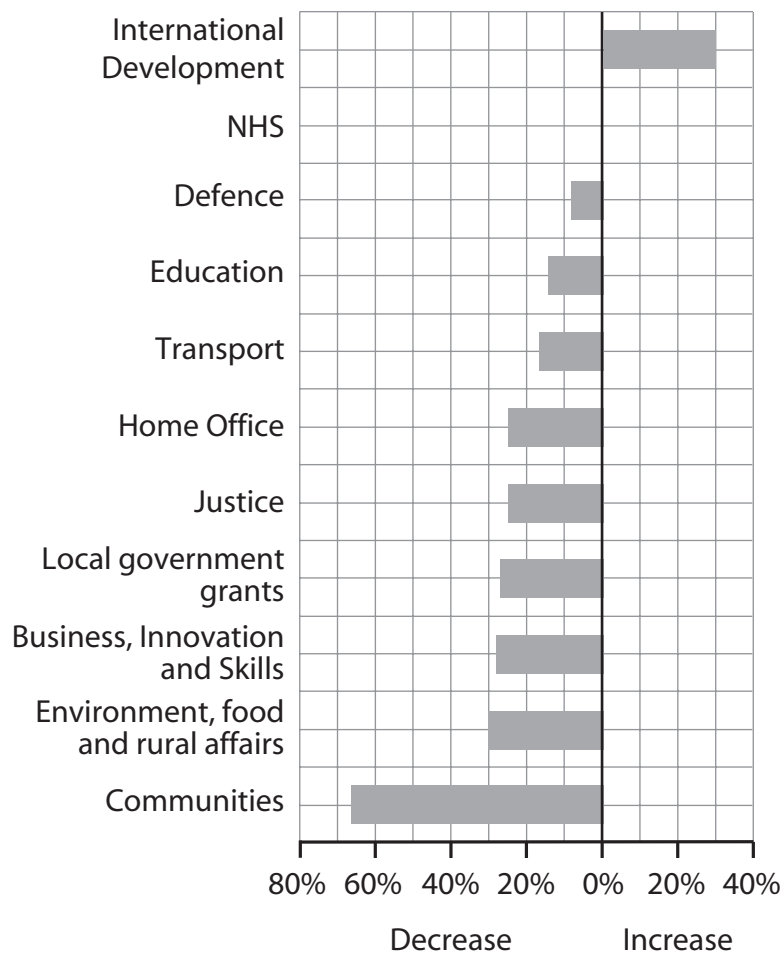
The Chancellor of the Exchequer, George Osborne, insisted that harsh medicine was vital to cut Britain's huge budget deficit, expected to be 10% of GDP in 2010–11. Total cuts in public sector spending of £81 billion are to be made by 2014–15. Nevertheless, total spending is planned to be 6% higher in cash terms in 2014–15 than 2010–11, but in real terms to be 3% lower. Some spending is beyond the Chancellor's control: debt interest is likely to rise from £43 billion this year to £63 billion by 2014–15 as a result of the surge in government borrowing.

5

As well as efficiency savings, one obvious way to reduce costs is to keep pay down. The government has already announced a two-year pay freeze for public-sector staff. State employers could carry on in this spirit after that, pointing out that the more pay can be kept down, the fewer the job losses. But job losses there will be, amounting to probably about half a million (out of a public sector workforce of about 6 million) by the end of 2014.

10

**Figure 1 Planned real percentage changes in UK public expenditure by government department between the fiscal years 2010–11 and 2014–15**



(Source for figure 1 and extract 1: © The Economist Newspaper, Oct 21st 2010)

## Extract 2 The inflation overshoot continues

For the fourth time this year, the Governor of the Bank of England, Mervyn King, has had to write to the Chancellor of the Exchequer explaining why inflation is above 3%. According to the Bank's own forecast published in its Inflation Report on November 10th 2010, Mr King is likely to be writing yet more letters in 2011 to George Osborne at the Treasury.

5

Figures out today from the Office for National Statistics showed that consumer prices rose by 3.2% in the year to October 2010. The new numbers triggered the letter, which the Governor has to write every three months if inflation remains more than a percentage point above (or below) the 2% target. It marked the ninth since the Bank of England's Monetary Policy Committee was given operational control over monetary policy in 1997. Since the spring of 2007, inflation has been above the 2% target in all but nine of the past 54 months.

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Britain is unusual in facing high inflation. Consumer prices in the Euro zone rose by 1.9% in the year to October 2010 and in the USA annual inflation was 1.1% in September 2010.

15

In his letter to the Chancellor, Mr King struck what has become a familiar note, by drawing a distinction between temporary upward and long term downward pressures on inflation. The inflation overshoot, he said, largely reflected a number of temporary factors, including the restoration of the main rate of VAT from its emergency rate of 15% during the recession to 17.5% in January 2010, past rises in oil prices and the continued effects of higher import prices resulting from the big 25% fall in sterling from mid-2007. These factors were offsetting the downward effects from spare capacity caused by the recession.

20

However, the temporary effects keep on coming. World food prices have risen by 31.5% in the past year. On January 4th 2011 the standard rate of VAT will rise again, to 20% as part of the coalition government's budget deficit reduction strategy.

25

Mr King argued that once these further temporary effects ended, inflation would fall back towards the target, due to spare capacity in the economy. He insisted that "the depth of the recession means that a margin of spare capacity is likely to persist for some while". However, there is considerable uncertainty about just how much spare capacity there is in the economy.

30

The main danger from the persistence of inflation overshoots is that people start to expect higher inflation and to demand higher wages. Mr King was concerned that this would make it "more costly to bring inflation down".

(Source: © *The Economist Newspaper*, Nov 16th 2010)

**16** With reference to Extract 1, explain the likely impact of a reduction in the budget deficit on the circular flow of income.

**(8)**

**(Total for Question 16 = 8 marks)**

## 17 Economic Growth and Unemployment

### Extract 1 The World Economy – a glimmer of hope?

The worst of the economic downturn is over only in the sense that the pace of global decline has peaked. Thanks to expansionary – and unsustainable – fiscal and monetary policies, output growth will eventually become positive again. However, growth, when it comes, will be too feeble to stop unemployment and spare capacity rising. The increasing output gap will keep many individuals and firms dependant on the government.

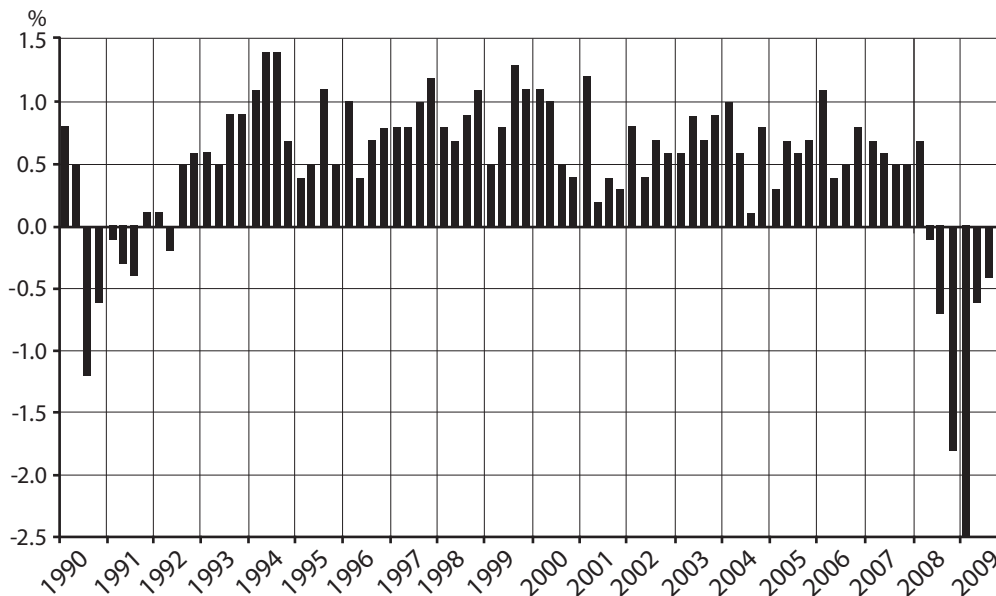
5

Consider what that means. Much of the rich world will see unemployment rates that reach double figures, and then stay there. Inflation will become negative thanks to falling fuel costs and record economic spare capacity, pushing down prices and wages. Government borrowing will soar because of falling growth, prolonged fiscal spending and the growing costs of bailing out the banks and other firms. Continuing high unemployment, years of falling investment and higher government borrowing will limit economies' underlying potential. It is clear that rates of economic growth will be lower than the long-term trend for years to come.

10

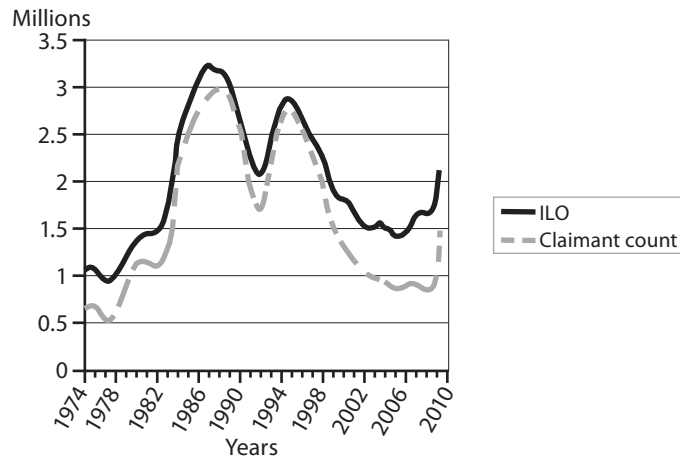
Source: adapted from *The Economist* 24 April 2009  
[http://www.economist.com/opinion/displaystory.cfm?story\\_id=13527685](http://www.economist.com/opinion/displaystory.cfm?story_id=13527685).

**Figure 1 UK Growth rates at a 30-year low**



Source: statistics.gov.uk

**Figure 2 Unemployment: ILO and the Claimant Count**



Source: [www.statistics.gov.uk](http://www.statistics.gov.uk)

**Extract 2 Unemployment: ILO and the Claimant Count**

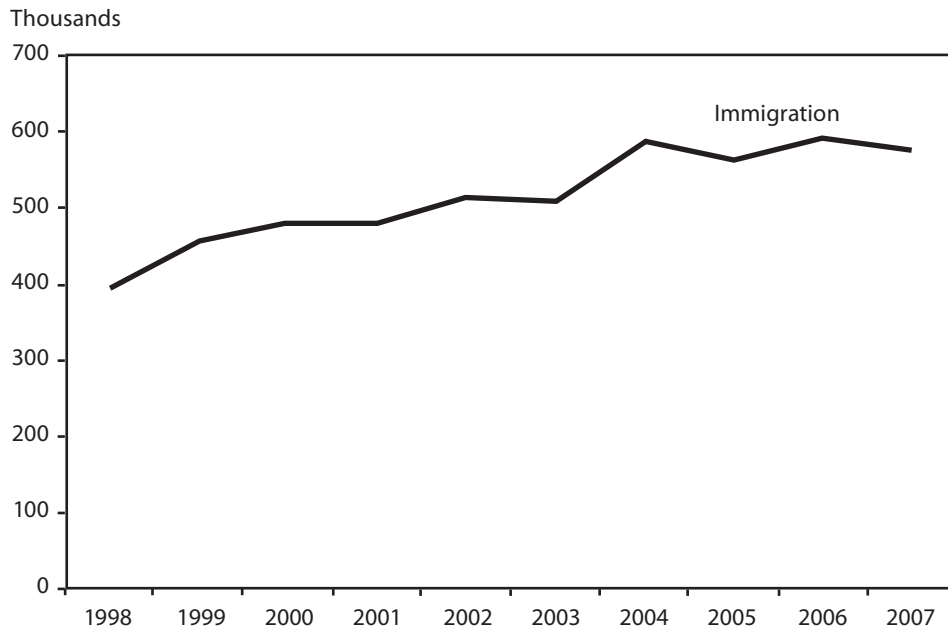
ILO unemployment is now 6.7% (2.1 million). In some regions it is much higher, for example the West Midlands (8.4%) and the North East of England (8.3%). While ILO unemployment is still much lower, so far, than in the recent recessions of the 1980s and 1990s, it is forecast that the level will go above 3 million in 2010. The employment rate for people of working age is 73.8% as measured by the International Labour Organisation (ILO).

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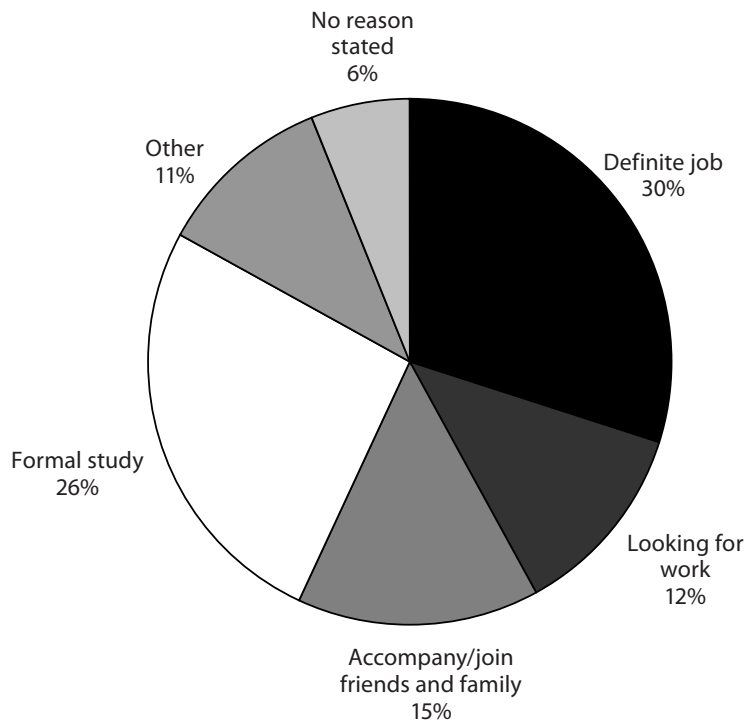
The claimant count has now increased continuously for 14 months. The claimant count rate in March 2009 was 4.5% (1.5 million), up 0.2% on the previous month and 2.1% higher than in March 2008.

Source: adapted from 'First Release labour market statistics' April 2009 ONS

**Figure 3 Total immigration into the UK 1998 to 2007**



**Figure 4 Estimates for the main reason for immigration to the UK, 2007**



Source: <http://www.statistics.gov.uk/pdfdir/tim1108/pdf>

17 With reference to Figure 1 and Extract 1, explain what is meant by an 'output gap' (*Extract 1, line 5*).

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**(Total for Question 17 = 4 marks)**

## Question 18

### Measures of economic performance

**Figure 1 Measures of economic performance, selected developed countries**

	<b>Economic growth % (2006)</b>	<b>Inflation (% increase in CPI) (2006)</b>	<b>Current account of the Balance of Payments (% of GDP) (2006)</b>	<b>Human Development Index (HDI) value (2005)</b>
France	2.0	1.8	-1.8	0.952
Germany	2.0	1.8	5.1	0.935
Spain	2.7	2.8	-10.2	0.949
United Kingdom	2.3	2.0	-3.6	0.946

Source: [www.imf.org](http://www.imf.org) (2007 report) and [www.undp.org](http://www.undp.org) (2007 report of HDI based on 2005 values)

**Figure 2 School enrolment figures and HDI ranks, selected developed and developing economies (2005)**

<b>Economy</b>	<b>Combined enrolment ratio for primary and secondary education (%)</b>	<b>HDI Rank</b>
France	99	10
Spain	98.5	13
United Kingdom	97	16
Pakistan	44.5	136
Kenya	60.5	148
Ethiopia	44.5	169
Niger	24	174

Source: <http://hdr.undp.org/en/statistics> (2007 report based on 2005 figures)



**18** Does Spain's current account balance as shown in Figure 1 represent a net *injection* or *withdrawal*? Explain your answer.

**(4)**

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**(Total for Question 18 = 4 marks)**

**END OF SECTION B**