

AS ECONOMICS

Paper 2 The national economy in a global context

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DO NOT WRITE ANY ANSWERS IN THIS INSERT. YOU MUST ANSWER THE QUESTIONS IN THE ANSWER BOOKLET PROVIDED.

CONTEXT 1: ECONOMIC SHOCKS AND THE UK ECONOMY

Questions 21 to 26

- **Extract A:** Sterling exchange rate, US\$ per £, 1 May 2016 to 30 April 2017
- **Extract B:** Tales of the unexpected
- **Extract C:** So what happens next?

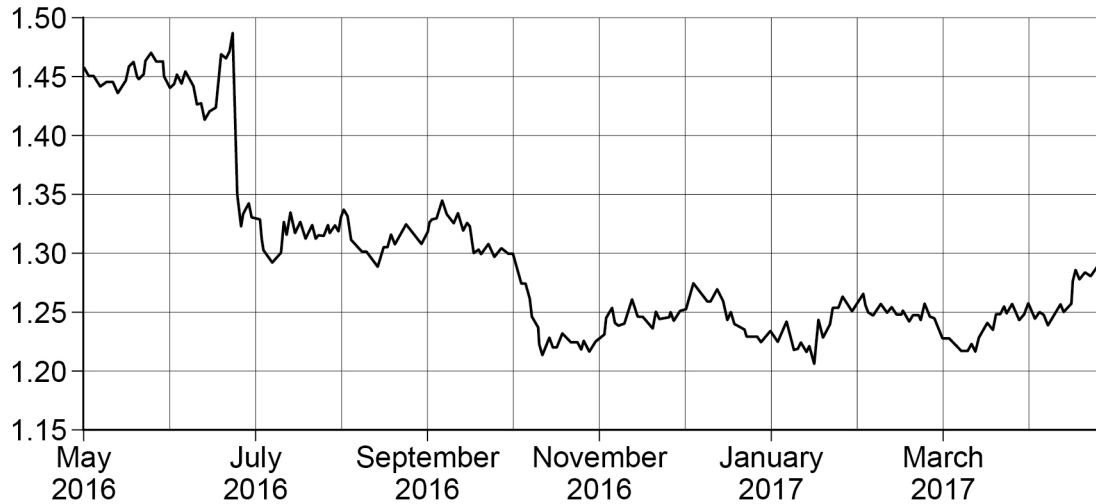
CONTEXT 2: A NEW APPROACH TO GOVERNMENT POLICY

Questions 27 to 32

- **Extract D:** Northern Powerhouse funding (January 2017)
- **Extract E:** A more active role for government
- **Extract F:** Does the new approach go far enough?

Context 1

Total for this context: 50 marks

ECONOMIC SHOCKS AND THE UK ECONOMY**Extract A: Sterling exchange rate, US\$ per £, 1 May 2016 to 30 April 2017**

Source:: News report, 2017

Extract B: Tales of the unexpected

Looking back, 2016 could be described as a year of unexpected events. When, contrary to many forecasts, UK citizens voted to leave the European Union, it was arguably one of the largest economic shocks to affect the UK economy in a long time.

It was widely anticipated that weaker aggregate demand and significantly slower economic growth would follow, but this did not occur. In the three months to the end of July 2017 unemployment fell by 75 000, bringing the unemployment rate down to 4.3%, its lowest since 1975. Quarterly growth peaked in the final quarter of 2016 at 0.7%, though the economy has grown more slowly in the first two quarters of 2017. 5

So why did the UK economy perform better than expected? There are several reasons. The Bank of England's Monetary Policy Committee loosened its monetary policy in an attempt to prevent a downturn in the economic cycle. The Chancellor of the Exchequer, Philip Hammond, stated that the Government was no longer committed to achieving a budget surplus by 2020. Amongst other plans, he announced more government spending on infrastructure, housing, and research and development, all designed to boost productivity. Consumer confidence did not appear to be lower and consumption remained strong. The UK economy was more resilient and adaptable than many people expected. 10 15

Source: News reports, 2017

Extract C: So what happens next?

It is clear that the UK economy faces an unpredictable future. Inflation is on the rise again, fuelled by cost-push pressures resulting from a fall in the value of the pound, making a rise in Bank Rate seem more likely. Firms may delay investment decisions until they have a better idea of what a post-Brexit UK will look like. Two banks have announced that they will each cut 1000 jobs in London and transfer staff to mainland Europe. Some economists believe that a reduction in the level of economic activity and an increase in unemployment are inevitable.

5

Yet whilst there are challenges ahead, there are also opportunities. During late 2016 the Government gave the go-ahead to the construction of the third runway at Heathrow airport in London, expected to cost around £17.6 billion, and to the extraction of shale gas in the North West of England. Other investment projects include plans by a firm in Cornwall to launch the lithium mining industry, and in Wales there is optimism regarding the production of tidal energy. In addition, the fall in the value of the pound is likely to increase demand for UK exports and reduce the trade deficit. All of these have the potential to create many jobs and lead to strong multiplier effects, both locally and nationally.

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Source: News reports, 2017

Turn over for Context 1 questions**Turn over ►**

Context 1 – Questions 21 to 26

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 Define 'budget surplus' **Extract B** (line 12). **[3 marks]**
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 Assume that the increase in national income as a result of the proposed Heathrow airport expansion is £29 billion.
- Use **Extract C** to calculate, to one decimal place, the value of the multiplier. **[4 marks]**
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 Use **Extract A** to identify **two** significant features of the changes in the sterling exchange rate over the period shown. **[4 marks]**
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Extract C (lines 7–9) states 'During late 2016 the Government gave the go-ahead to the construction of the third runway at Heathrow airport in London.'
- Draw an AD/AS diagram to show **both** the short-run **and** long-run effects 'on macroeconomic equilibrium' of investment in a large infrastructure project such as this. **[4 marks]**
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Extract B (lines 9–11) states 'The Bank of England's Monetary Policy Committee loosened its monetary policy in an attempt to prevent a downturn in the economic cycle.'
- Explain how monetary policy might help to prevent a downturn in the economic cycle. **[10 marks]**
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Extract C (lines 5–6) states 'Some economists believe that a reduction in the level of economic activity and an increase in unemployment are inevitable.'
- Use the extracts and your knowledge of economics to assess the view that when an economy experiences a negative economic shock there will always be a sustained increase in unemployment. **[25 marks]**

There are no questions printed on this page

Turn over for Context 2

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Context 2**Total for this context: 50 marks****A NEW APPROACH TO GOVERNMENT POLICY****Extract D: Northern Powerhouse * funding (January 2017)**

Local enterprise partnership (LEP) **	Amount of funding, £m
Cheshire and Warrington	43.3
Cumbria	12.7
Greater Manchester	130.1
Humber	27.9
Lancashire	69.8
Leeds City Region	67.5
Liverpool City Region	72.0
North Eastern	49.7
Sheffield City Region	37.8
Tees Valley	21.8
York, North Yorkshire and East Riding	23.7

*The Northern Powerhouse refers to a plan to boost economic growth in the North of England, particularly in Manchester, Liverpool, Leeds, Sheffield and Newcastle.

**Local enterprise partnerships (LEPs) involve local authorities and businesses working together to help determine local economic priorities and lead economic growth and job creation within the local area.

Source: News reports, March 2017

Extract E: A more active role for government

In January 2017, the Prime Minister, Theresa May, launched the Modern Industrial Strategy. She explained that this industrial policy, part of the Government's supply-side policy, would be 'underpinned by a new approach to government...a new, active role that backs business and ensures more people in all corners of the country share in the benefits of its success'. The previous Coalition Government had taken a less active role in the economy, and had placed a greater reliance on the private sector to ensure economic prosperity. 5

The policy named five areas that could receive 'special government support': low-carbon-emission vehicles; digital technology in manufacturing; the creative sector; the nuclear industry; and life sciences. Potentially millions of pounds are available for research and development to aid innovation and technological progress. The Government has also promised a new system of technical education, better transport infrastructure and regional support, such as that given to the Northern Powerhouse. All this combined should contribute to steady and sustainable economic growth. 10

In addition, the tax and benefits system will continue to be an important part of Government policy. The creation of incentives for individuals to work, and for UK and foreign firms to invest, must be balanced with the need to raise sufficient revenue to provide crucial public services such as healthcare and education. Progressive taxation in the UK has been reduced in recent years, and the 2017 Budget Report stated the intention to reduce the rate of corporation tax further to 17% by 2020. 15

Source: News reports, March 2017

Extract F: Does the new approach go far enough?

Whilst many economists and politicians broadly welcomed the Government's new approach, some are concerned that it will only help to improve macroeconomic performance in the longer term. The benefits of the new technical education system, for example, might take a generation to materialise.

The chief economist for the Joseph Rowntree Foundation charity is concerned that 'millions of people already in the workforce are struggling with low pay and insecure work'. Lower standards of living, job insecurity and uncertainty lead to falling consumer spending and aggregate demand, which may lead to an even greater fall in investment. This makes it even more difficult to achieve increases in productivity. 5

Regional imbalances also exist. The south-east is renowned for high skills, high levels of employment and good transport links, yet some areas, such as the north-east, are plagued by structural unemployment caused by industrial decline. 10

Despite the best intentions, the new Modern Industrial Strategy might not be enough to allow everyone in all corners of the country to share in its success. In addition, there are those economists who are wary of increased government intervention. They believe that as government officials suffer from imperfect knowledge, funds could be misallocated and the promised benefits may not arise. Even worse, they say, there is the possibility of spending cuts and higher taxation in the future. 15

Source: News reports, March 2017

Turn over for Context 2 questions

Turn over ►

Context 2 – Questions 27 to 32

- 2 7** Define 'progressive taxation' **Extract E** (line 17). **[3 marks]**
- 2 8** Use **Extract D** to calculate the median amount of funding allocated to the local enterprise partnerships in the Northern Powerhouse. **[4 marks]**
- 2 9** Use **Extract D** to identify **two** significant features of the funding allocated to the Northern Powerhouse. **[4 marks]**
- 3 0** **Extract F** (lines 8–9) states 'This makes it even more difficult to achieve increases in productivity.'
- Draw an AD/AS diagram to show the effects of **both** short-run **and** long-run productivity gains on macroeconomic equilibrium. **[4 marks]**
- 3 1** **Extract E** (lines 18–19) states 'the 2017 Budget Report stated the intention to reduce the rate of corporation tax further to 17% by 2020.'
- Explain how a reduction in corporation tax on firms' profits might lead to supply-side improvements in the economy. **[10 marks]**
- 3 2** **Extract E** (lines 3–4) states that there is 'a new approach to government...a new, active role that backs business and ensures more people in all corners of the country share in the benefits of its success'.
- Use the extracts and your knowledge of economics to assess the view that a more active government industrial policy will make a significant improvement in macroeconomic performance. **[25 marks]**

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