

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: MANAGING THE UK ECONOMY

Questions 21 to 26

- **Extract A:** Lending to households and businesses, annual percentage change, 2004 to 2015
- **Extract B:** Consumer borrowing is rising
- **Extract C:** Is history repeating itself?

CONTEXT 2: UK WAGES AND COMPETITIVENESS

Questions 27 to 32

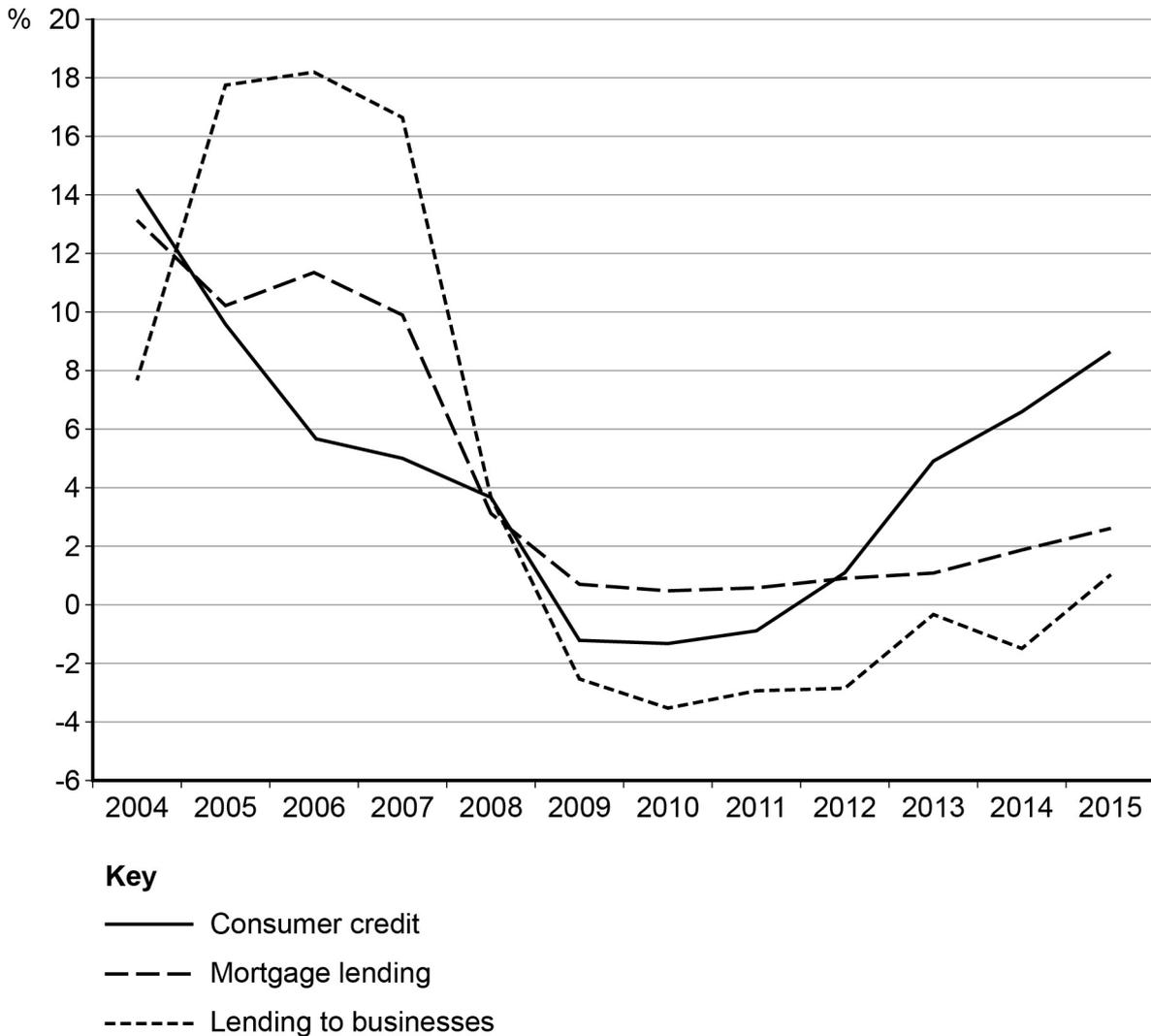
- **Extract D:** UK balance of payments on current account, January 2014 to March 2016, £ billion
- **Extract E:** Balance of payments problems
- **Extract F:** Productivity and competitiveness

Context 1

Total for this context: 50 marks

MANAGING THE UK ECONOMY

Extract A: Lending to households and businesses, annual percentage change, 2004 to 2015



Note: Consumer credit is unsecured borrowing such as credit cards, personal loans and overdrafts

Source: Bank of England Inflation Report, February 2016

Extract B: Consumer borrowing is rising

Japan's central bank introduced negative interest rates in January 2016, joining some European countries that have already followed this route in an attempt to stimulate their economies. Should the UK follow the same route? With the economy growing and unemployment falling, many economists see no reason for such a move. Some nominal interest rates are lower than inflation, and for many in the UK the real interest rate on their savings has been negative for a while. 1
5

Although wages have risen, consumers are still borrowing more and using their savings to fund their spending. Despite the introduction of tighter controls on mortgage lending, house prices have been rising over the past few years and this has increased homeowners' wealth, contributing to the growth in household consumption. Household debt at the end of December 2015 stood at £1455bn compared to £1424bn at the end of December 2014. The average debt per household, including mortgages, was £53 904 in December 2015. Cheaper credit may be a reason for the rise in borrowing and debt but other factors, such as the Government's 'Help to Buy' scheme may have caused house prices to rise. 10

The concern is that a recovery based on consumer spending and rising debt may not be sustainable in the long run. As consumers continue to borrow more and empty their savings accounts, what will happen when interest rates eventually rise? 15

Source: News reports, January 2016

Extract C: Is history repeating itself?

In 2006, the UK economy was in a very different place. Unemployment was around 5%, inflation was close to its 2% target and earnings were rising at 4% per year. Today, although employment remains strong, average earnings are rising more slowly than before the financial crisis. 1

When the crisis began, the UK responded with a number of both fiscal and monetary policy measures. Fiscal policy was relaxed during the height of the crisis when the then Chancellor of the Exchequer, Alistair Darling, cut Value Added Tax (VAT) from 17.5% to 15% and allowed the budget deficit to increase from around £40bn in 2007 to over £154bn in 2009. The Bank of England cut Bank Rate from 5.75% in 2007 to 0.5% in 2009 and introduced a programme of quantitative easing (QE), designed to boost lending and reduce long-term interest rates. The pound sterling exchange rate also fell by about 25% between 2007 and 2009. 5
10

In 2010, the Coalition Government introduced austerity measures. A tighter fiscal policy was adopted to reduce the budget deficit. Meanwhile, loose monetary policy was used to bring about a recovery of the UK economy. Some economists have blamed the tightening fiscal policy for the slow growth of the UK economy between 2010 and 2012. 15

Austerity measures have continued but concessions have been made. There have been significant tax cuts. Corporation Tax was reduced between 2010 and 2016 from 28% to 20%, and the tax-free personal allowance for individuals has increased from £6 475 to £11 000. However, VAT is now 20% and there are continued cuts to public expenditure. 20

Some believe that the government should be spending more on infrastructure, support for industry and measures to encourage improvements in productivity.

Source: News reports, January 2016

Turn over for Context 1 questions

Turn over ►

Context 1 – Questions 21 to 26

- 2 1** Define the term 'real interest rate' **Extract B** (line 5). **[3 marks]**
- 2 2** The price of a television is £500 without VAT. Use **Extract C** to calculate the decrease in the amount of VAT that would have to be paid on this television as a result of the tax cut introduced by Alistair Darling. **[4 marks]**
- 2 3** Use **Extract A** to identify **two** significant points of comparison between the growth of mortgage lending and the growth of consumer credit over the period shown. **[4 marks]**
- 2 4** **Extract B** (lines 8–10) states 'House prices have been rising over the past few years and this has increased homeowners' wealth.'
- Draw an AD/AS diagram to show the impact of an increase in household wealth on both real national income and the price level. **[4 marks]**
- 2 5** **Extract B** (line 12) states 'The average debt per household, including mortgages was £53 904 in December 2015.'
- Explain **two** factors that influence the willingness of UK households to borrow. **[10 marks]**
- 2 6** **Extract C** (lines 13–15) states 'A tighter fiscal policy was adopted to reduce the budget deficit. Meanwhile, loose monetary policy was used to bring about a recovery of the UK economy.'
- Use the extracts and your knowledge of economics to assess the contribution that fiscal policy **and** monetary policy can make in sustaining the recovery of an economy, such as the UK. **[25 marks]**

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Turn over for Context 2

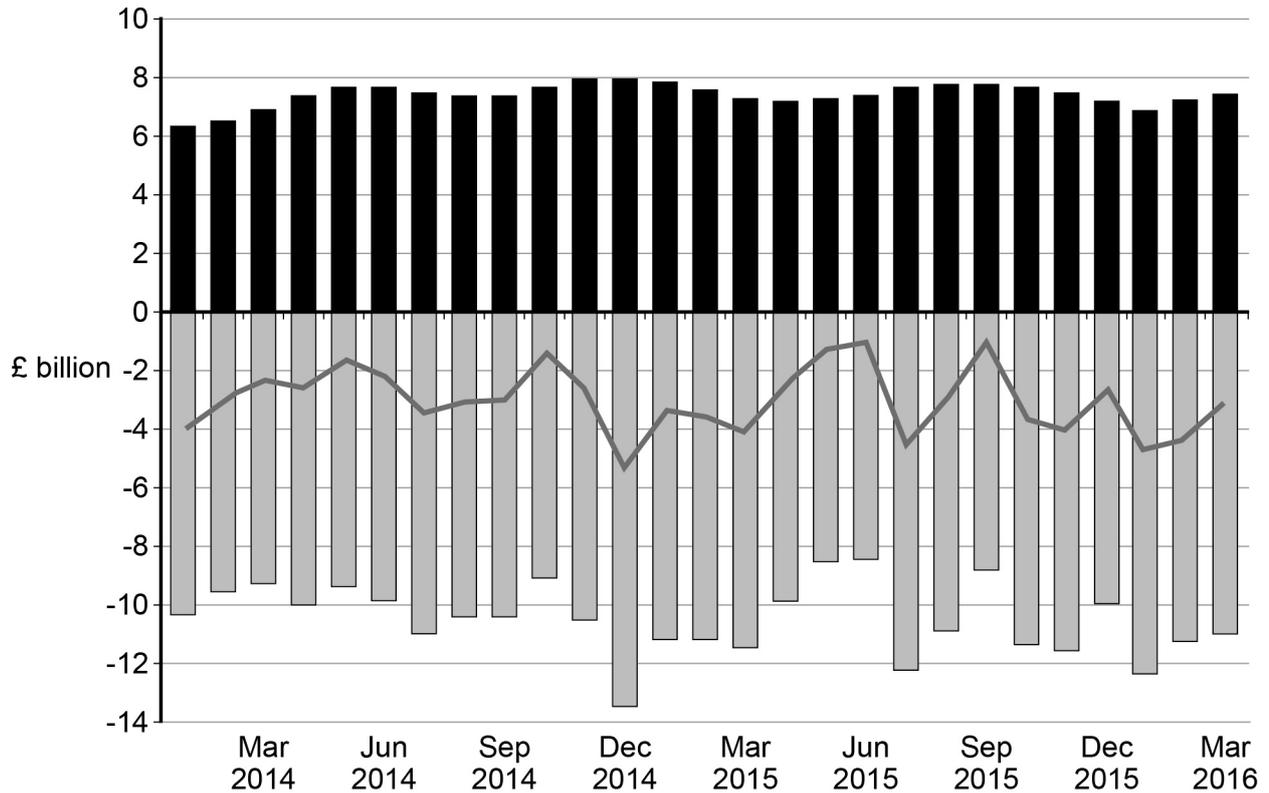
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Context 2

Total for this Context: 50 marks

UK WAGES AND COMPETITIVENESS

Extract D: UK balance of trade in goods and services, January 2014 to March 2016, £ billion



Key

- Balance of trade in goods
- Balance of trade in services
- Balance of total UK trade

Note: The data show the balance of trade in goods and services for each month between January 2014 and March 2016.

Source: Office for National Statistics, May 2016

Extract E: Balance of payments problems

The manufacturing sector fell into recession in 2015; the causes include a stronger pound, higher energy prices and weakening global growth. In addition, the threat of a crisis in emerging market economies such as Mexico, Indonesia and Thailand has done little to fuel confidence in the growth of the global economy. 1

However, it is not all doom and gloom as the UK economy continues to grow and low inflation has led to a rise in real wages. Nevertheless, the median real wage is below the 2004 level of £548.60 per week, standing at £527.70 in 2015. If real wages are to continue to increase, a sustained growth in productivity is essential. Without an increase in productivity, UK manufacturing industry will not be able to compete on the world stage. 5

Consumers have seen a small increase in their real wages since 2014 and the savings ratio has slipped to almost half its 10% long-run average. Consumers have increased their spending by using their savings and taking advantage of cheap loans, as interest rates remain historically low. The increase in spending may be a factor contributing to the growing deficit on the balance of trade in goods and services. 10

Source: News reports, January 2016

Extract F: Productivity and competitiveness

In January 2016, the International Monetary Fund (IMF) reduced its forecasts of global growth for the next two years. Falling oil prices and fears over China's slowdown have led the Governor of the Bank of England to indicate that interest rates are unlikely to rise in the near future. 1

Following the IMF's announcement, the pound fell against the dollar. This may give a boost to the UK's exporting industries and result in an improvement in the balance of trade. However, productivity remains a key issue in improving competitiveness and aiding the recovery of the economy. Without an increase in productivity, it is unlikely that a rise in real wages can be sustained. The government is hoping for an export-led recovery but, at present, the growth in the UK economy is heavily dependent on increasing consumption. 5
10

The British Chambers of Commerce (BCC) reported that manufacturing exports are stagnating and with the economy overly dependent on the service sector, export-led growth may take some time to achieve. The BCC claim a number of supply-side measures will be required, such as improving the economy's infrastructure and the skills of the workforce. However, with the European Union economies struggling to recover, it may be some time before exports and the balance of trade improve. It is clear that there is much to be done if the UK is to pay its way with the rest of the world. 15

Source: News reports, January 2016

Turn over for Context 2 questions

Turn over ►

Context 2 – Questions 27 to 32

- 2 7** Define the term 'deficit on the balance of trade in goods and services' **Extract E** (line 14).
[3 marks]
- 2 8** Use **Extract E** to calculate, to **two** decimal places, the percentage change in the median real wage between 2004 and 2015.
[4 marks]
- 2 9** Use **Extract D** to identify **two** significant points of comparison between the balance of trade in goods and the balance of trade in services over the period shown.
[4 marks]
- 3 0** **Extract E** (lines 1-2) states '...the causes include a stronger pound, higher energy prices'.
Draw an AD/AS diagram to show the impact of higher energy prices on the price level and real output.
[4 marks]
- 3 1** **Extract F** (lines 7–8) states 'productivity remains a key issue in improving competitiveness and aiding the recovery of the economy.'
Explain **two** factors that may have contributed to low productivity in the UK.
[10 marks]
- 3 2** **Extract F** (lines 16-17) states 'there is much to be done if the UK is to pay its way with the rest of the world.'
Use the extracts and your knowledge of economics to assess the policies that could be used to reduce the UK's balance of trade deficit.
[25 marks]

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