



GCE A level

1134/01

ECONOMICS – EC4

P.M. TUESDAY, 10 June 2014

2 hours

1134
010001

ADDITIONAL MATERIALS

In addition to this examination paper, you will need a 12 page answer book.

INSTRUCTIONS TO CANDIDATES

Use black ink or black ball-point pen.

Answer **one** question from Section A.

You are advised to spend no more than 1 hour and 15 minutes on Section A.

Answer **one** question from Section B.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question or part-question. Section A has 40 marks and Section B has 20 marks.

You are reminded that assessment will take into account the quality of written communication used in answers that involve extended writing (Section B).

You are reminded that the essay questions in Section B are synoptic and so will test understanding of the connections between the different elements of the subject.

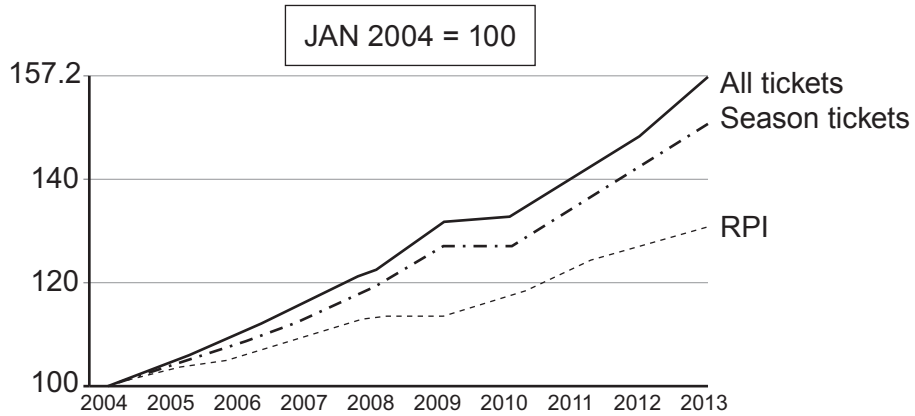
SECTION A

Answer **one** question from this section.

Study the information below and then answer the questions that follow.

1. HS2: George Osborne hails ‘engine of growth’ for north as high-speed rail route disclosed

Figure 1 – Rail fares and inflation

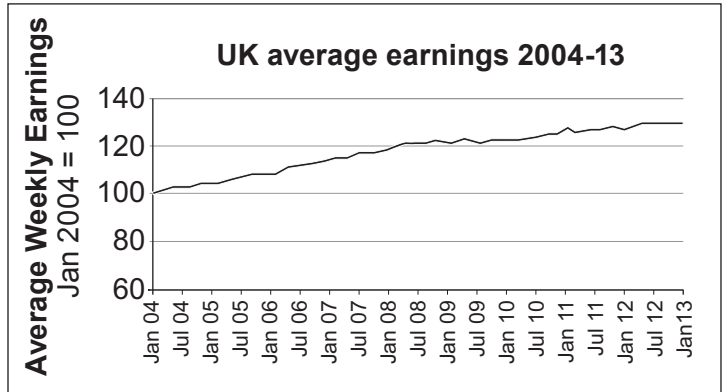


Source: Office of Rail Regulation

Figure 2 – HS2 planned route



Figure 3 – UK average earnings



Source: ONS

Figure 4 – UK Government spending

	2011-12 £bn	Real % change on previous year
Health	107	-1.2
Education	56	-5.7

The Chancellor insisted that the UK's second high-speed line (HS2) will be an "engine of growth for the north of the UK" and that it will help to end the country's reliance on the City of London. The HS2 line will cut journey times between London and Manchester to one hour and eight minutes. Under the plans a journey from London to Leeds will take an hour and 22 minutes—50 minutes quicker than the current journey time. The 225 mph trains will link London with Birmingham, Manchester and Leeds by 2033. The Government has said the project will bring wide-ranging benefits to UK businesses and create 100,000 jobs.

Patrick McLoughlin, the Transport Secretary, said the train line will take pressure off the UK's transport network despite conceding that the project will be "annoying" for some people. Mr McLoughlin said he understands that some people will be "very opposed to the route".

"Overall one has got to look at the long-term chances for the United Kingdom. I think the truth of the matter is that we've got to look to the future. We haven't actually built a railway line in this country north of London for 120 years. What this is doing is actually saying that to increase rail services, we need to actually increase rail capacity". He said that the Government eventually wants to link Scotland in phase 2 of the HS2 project. Construction on the extension could start in the middle of the next decade with the line open by 2032-33. It is expected to cost about £33 billion over the next 20 years.

But the Government will face huge opposition from more than 70 groups that are against the plans. A number of councils along the route have also said that the project will increase pollution and is a waste of taxpayers' money.

The announcement comes just after this month's increase in rail fares in England, Scotland and Wales of an average of 3.9%, the third successive year in which the rise has outstripped RPI inflation. The cost of an average rail season ticket in Great Britain has risen to £2,191, equivalent to 8% of the average UK salary and considerably higher than the £1,441 fuel cost of driving to work. Many rail travellers are concerned that as both rail passengers and taxpayers they are already paying enough for the railways. The Government's longstanding policy, however, is that the burden of paying for rail travel and investment in the network should be shifted from taxpayers to rail passengers. This requires cuts in Government subsidies and increases in fares.

The North Wales for HS2 group, however, disagrees "even though the line won't cross over the Welsh border, we know it will bring us huge benefits if properly done. The new line will make it dramatically quicker to get to North Wales from London via Manchester and Liverpool. Suddenly, getting business representatives to North Wales and back in a day looks easy. It will also be easier for people and goods to travel to England and Europe".

Adapted from BBC News, 28 Jan 2013

- (a) Explain what happened to rail fares between 2004 and 2013. [8]
- (b) Explain George Osborne's argument that the HS2 link would be an "engine of growth for the north of the UK" (lines 1-2). [8]
- (c) Discuss whether improvements in the rail network should be financed by an increase in fares rather than by increasing subsidies. [12]
- (d) Discuss the view that it would be better to spend £33 billion on improving education and health services than on the HS2 link. [12]

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2. British economy faces threat of lost decade

A week in which the UK's high street looked to be on course for total collapse has raised fears that we could now be in the middle of a long period of stagnation.

Figure 1 – GDP by sector

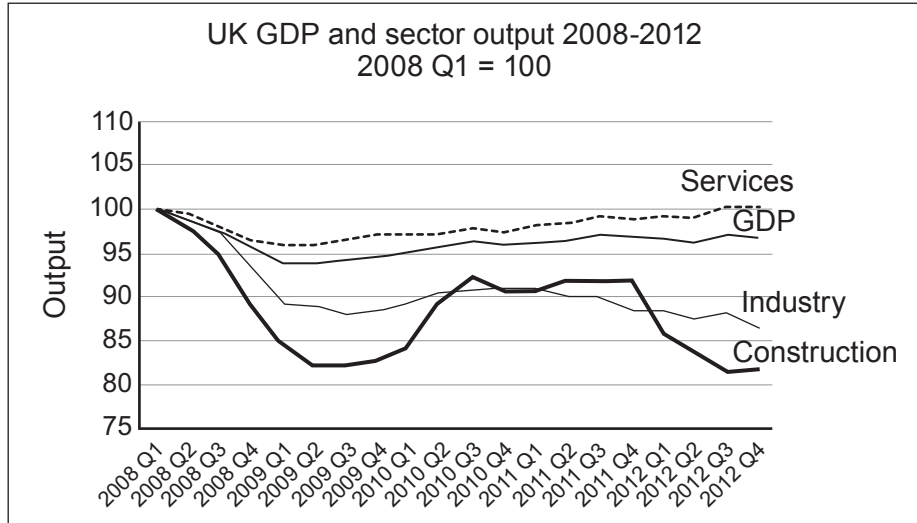


Figure 2 – UK house prices

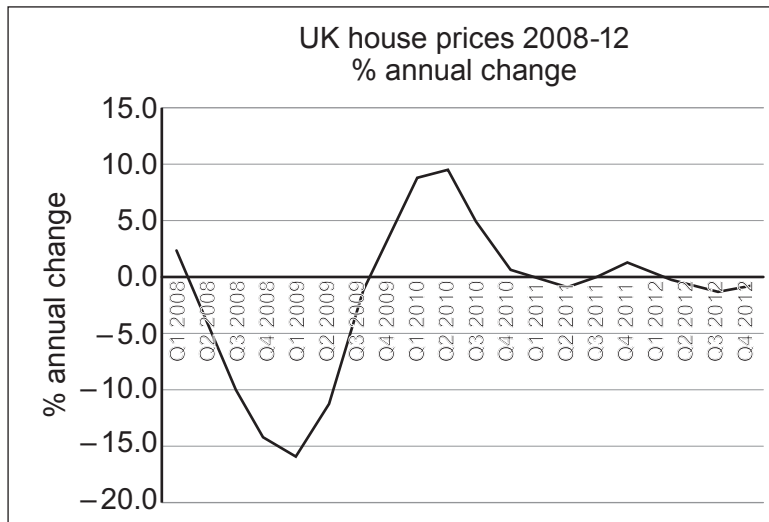


Figure 3 – UK mortgage rates

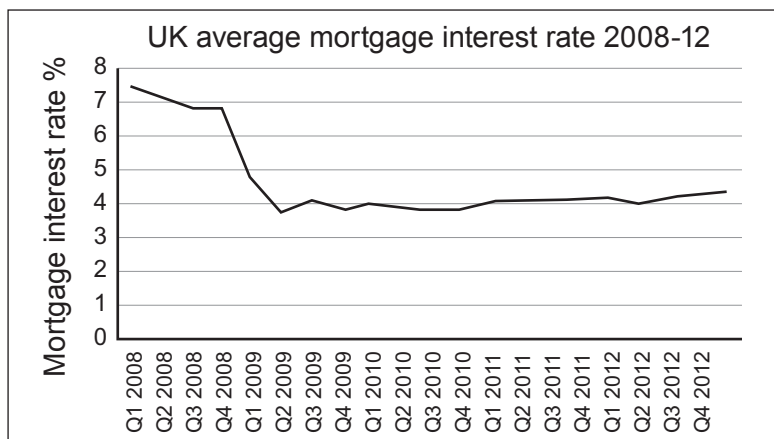
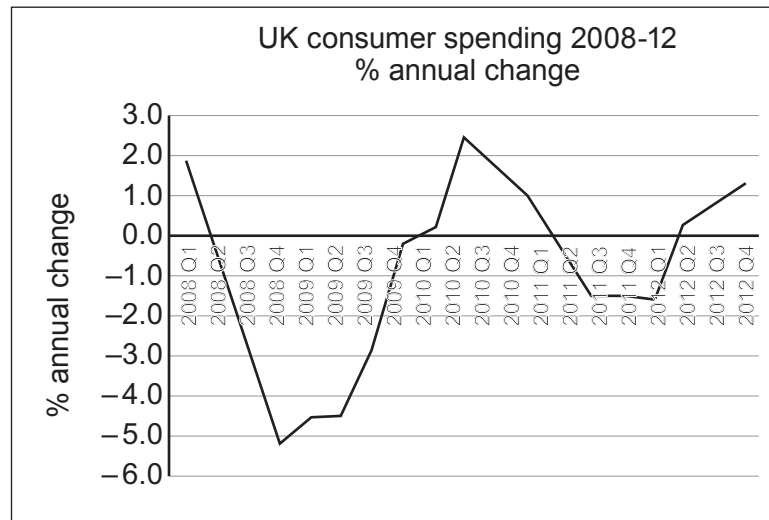


Figure 4 – UK consumer spending



5 There could be few better symbols of the fragile state of Britain's recession-hit economy than the news that with HMV and Blockbuster joining the dismal list of retailers forced into administration, an extraordinary 1,400 shops on high streets up and down the county are now at risk of closure within less than a month. Together with the boom in Internet sales, the chronic weakness of consumer demand in Britain's stagnant economy has been a key factor in driving so many well-known names out of business.

10 If, as many City analysts expect, official figures reveal on Friday that the UK economy slipped into reverse in the final quarter of 2012, Chancellor George Osborne will face fresh questions about whether the UK is heading for its own "lost decade".

15 David Kern, chief economist at the British Chambers of Commerce (BCC) which represents many smaller firms, says he backs the Chancellor's broad aim of tackling the deficit, but believes spending in some key areas could be increased without him losing credibility. That might mean, for example, improving the country's infrastructure, such as transport, schools and hospitals. Peter Spencer, of forecasting group the Ernst and Young Item Club, agrees: "If the Government tries to create growth through spending on infrastructure – let's say £15bn, financed by borrowing – over time it would get it back in tax and reduced unemployment benefits."

20 With little hope that Osborne will relax his grip on the finances, one area some economists feel it is ready for a rethink is the role of the Bank of England in guiding the economy. Mark Carney, the Canadian hired by Osborne to take over from Sir Mervyn King as Bank of England Governor this summer, sparked excitement before Christmas when he suggested that it might be time to drop the inflation-targeting regime that has evolved since the 1990s.

25 Carney suggested that when, as now, interest rates are near zero and growth is weak, it might be right for central banks such as the Bank of England to take more radical action. It should be announcing that it plans to keep interest rates low for a long time, at least until mid-2015.

30 If that should fail, he added, the inflation target could be dropped. At times when growth is very low, a bit of inflation should be less of a concern than the impact on the economy of a long period of stagnation. The Bank should be able to forget its concerns about inflation and go all out to kick-start growth. Spencer at the Item Club backs a change of regime: "It's the combination of inflation and growth that is important."

35 However, even within its current target of keeping inflation close to 2%, the Bank has ignored its target and allowed inflation to remain higher than the target rate, because, as King has repeatedly argued, bringing it back down to 2% more rapidly would have led to an even deeper recession and higher unemployment.

40 However Adam Posen, a former member of the Bank of England's Monetary Policy Committee (MPC) is cautious about dropping the inflation target, despite calling for the Bank to take more aggressive action, such as lending directly to cash-starved businesses. He warns that ditching the inflation target might immediately be seen by financial markets as a decision to let inflation rise.

Instead of changing the monetary policy regime, Posen would like to see Chancellor Osborne relax his grip on the nation's purse strings and abandon his obsession with cutting the public sector deficit. "When you've implemented a policy and it hasn't worked, it is time to change the policy."

45 A climbdow would be humiliating for a Chancellor who has pinned his reputation on continuing austerity, but the weak recovery, which has seriously damaged the Treasury's fiscal plans, has already resulted in Osborne having to extend the planned period of austerity for three years longer than he had hoped, to 2017-18.

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- (a) Using the data in Figure 1, explain how the output of different sectors of the economy changed between 2008 and 2012. [8]
- (b) Explain possible reasons for the changes shown in Figure 1. [8]
- (c) Discuss the possible effects of the Bank of England "announcing that it plans to keep interest rates low for a long time, at least until mid-2015" (line 26). [12]
- (d) Discuss the argument that George Osborne should "relax his grip on the nation's purse strings and abandon his obsession with cutting the public sector deficit" (lines 42-43). [12]

SECTION B

Answer one question from this section.

- 3. Discuss the view that a policy of significant cuts in the rates of all taxes is the best way to create long-term growth. [20]
- 4. "A sudden increase in aggregate demand in the UK would be more likely to increase inflation than to reduce unemployment." Discuss. [20]
- 5. "The protectionist policies of rich industrialised countries are the largest obstacle to the development of poor developing countries." Discuss. [20]

END OF PAPER