



## **Economics Questions By Topic:**

### **Supply-Side Policies (2.6.3)**

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

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 The Foundry, 77 Fulham Palace Road, W6 8JA

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## SECTION A

Write your answers in the spaces provided.

1 Which **one** of the following is an example of a market-based supply-side policy? (1)

- A** A reduction in unemployment benefits
- B** Construction of new transportation links
- C** Government-funded apprenticeship schemes
- D** Increased government spending on healthcare

(Total for Question 1 = 1 mark)

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2 The International Monetary Fund has called on the G20 group of large industrialised countries to boost government spending on infrastructure.

(Source: <https://www.theguardian.com/business/2016/jul/23/imf-calls-for-more-government-spending-as-rate-cuts-lose-their-impact>)

Which **one** of the following would be an example of government spending on infrastructure?

(1)

An increase in:

- A construction work on new railway lines
- B interest payments on the national debt
- C salaries for teachers
- D unemployment benefit payments

**(Total for Question 2 = 1 mark)**

**3** The UK Government is planning to cut the rate of corporation tax on all pre-tax profits of companies to 17% by 2020.

(Source: adapted from <https://www.ft.com/content/7579f124-5742-11e7-9fed-c19e2700005f>)

(a) This would be an example of:

(1)

- A** a contractionary monetary policy
- B** an exchange rate policy
- C** an expansionary monetary policy
- D** a supply-side policy

(b) If a company makes £500 000 pre-tax profit in 2020, calculate how much corporation tax it will pay. Assume that the government cuts the rate of corporation tax as planned.

(2)

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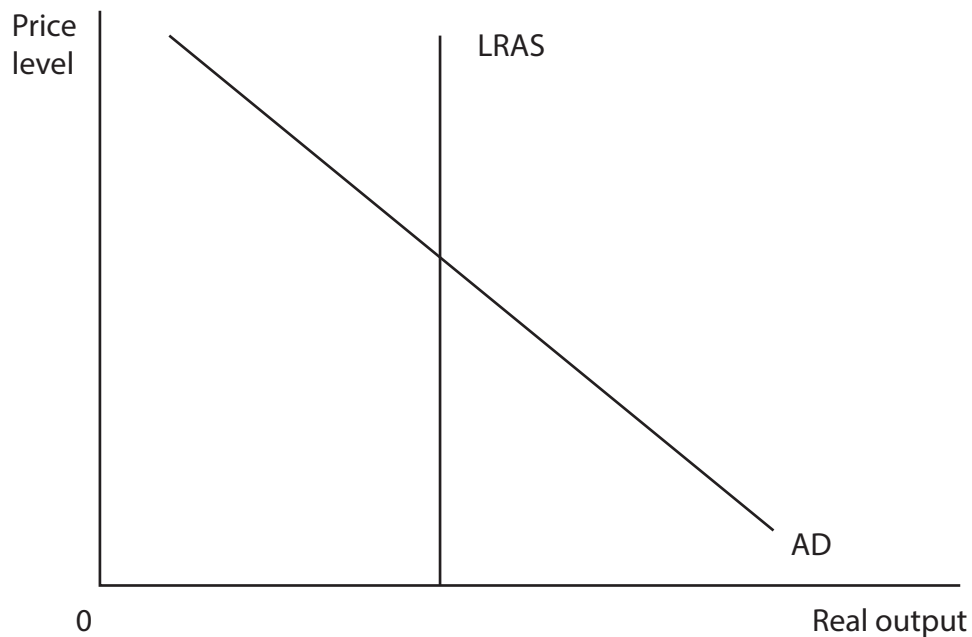
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**(Total for Question 3 = 3 marks)**

- 4 The diagram below shows the aggregate demand (AD) and a possible long-run aggregate supply (LRAS) for the UK.



- (a) Annotate the diagram above to show the likely impact of government policy to promote business competition on the equilibrium level of real output and price level.

(2)

- (b) Which **one** of the following is an interventionist supply-side policy?

(1)

- A** An improvement in infrastructure
- B** An increase in indirect taxation
- C** An increase in interest rates
- D** An increase in the regulation of markets

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

5 Which **one** of the following factors is most likely to cause an increase in the long-run aggregate supply?

(1)

- A** Decrease in investment
- B** Increase in relative productivity
- C** Increase in the level of unemployment benefits
- D** Reduced access to credit for consumers and businesses

**(Total for Question 5 = 1 mark)**

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6 Which **one** of the following is most likely to cause a rightward shift in the aggregate supply curve?

(1)

- A** A decrease in real output
- B** A rise in price level
- C** A fall in price level
- D** An increase in productivity

**(Total for Question 6 = 1 mark)**

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**END OF SECTION A**



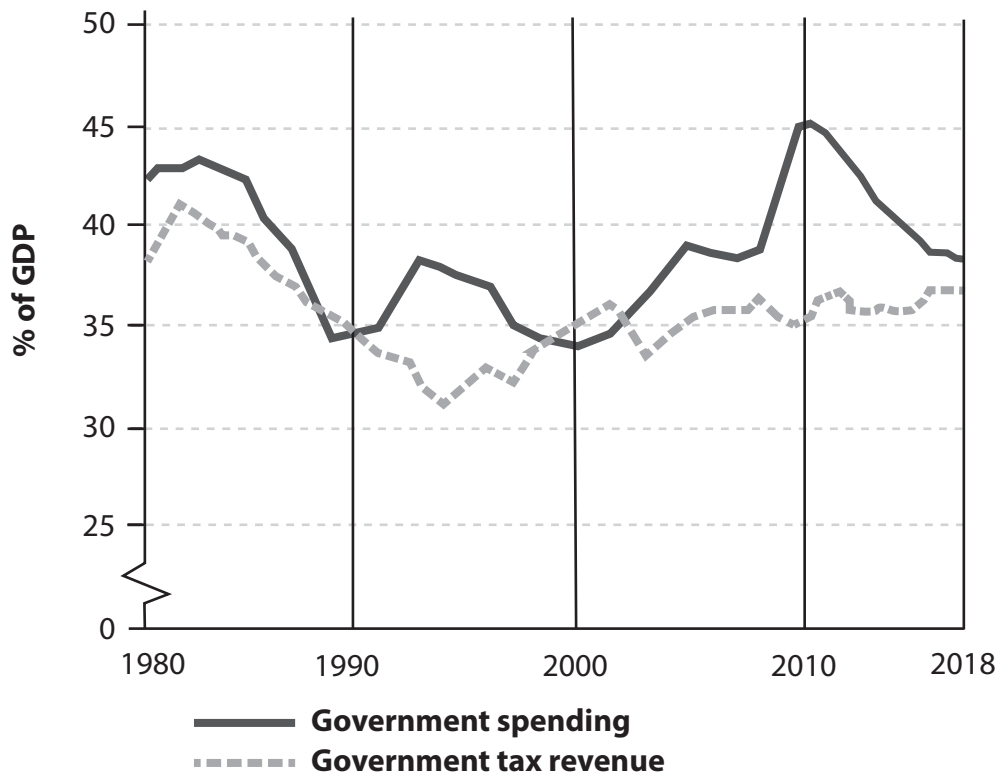
## SECTION B

Read all extracts/figures before answering.  
Write your answers in the spaces provided.

### Question 7

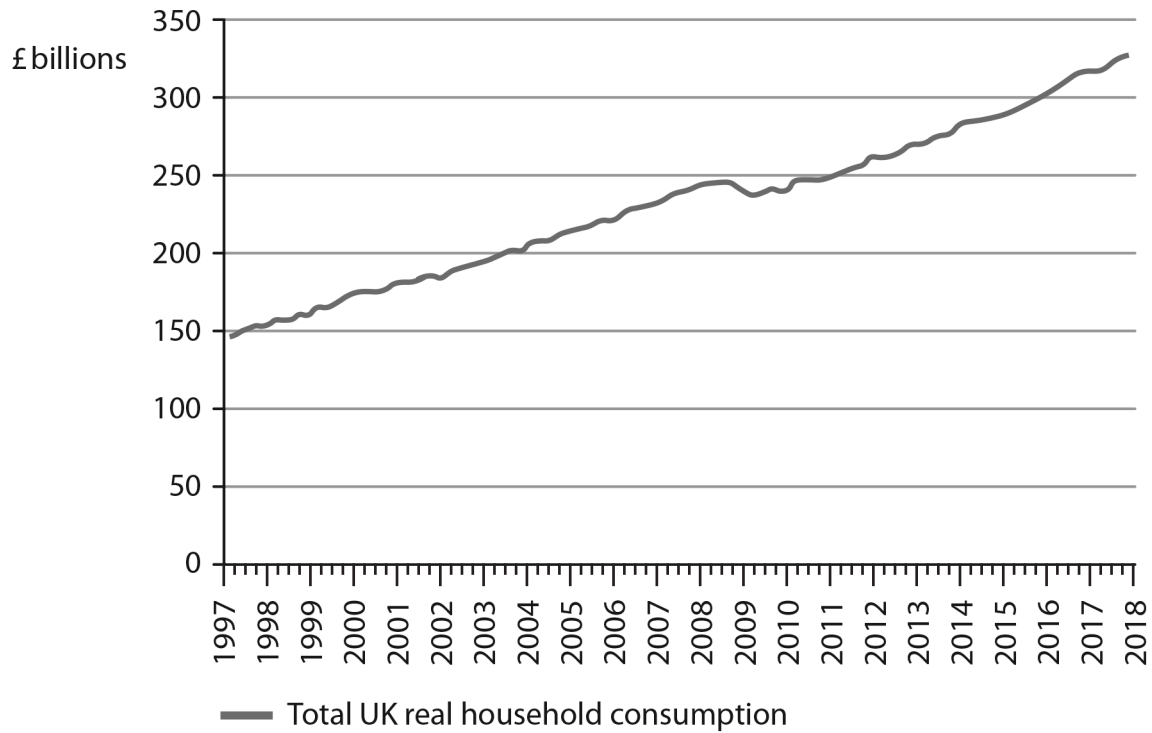
#### UK government budget and household consumption

Figure 1: UK government spending and tax revenue as % of GDP, 1980–2018



(Source: adapted from Office for Budget Responsibility (OBR), [http://cdn.obr.uk/EFO-MaRch\\_2018.pdf](http://cdn.obr.uk/EFO-MaRch_2018.pdf) © Crown copyright 2018)

**Figure 2: UK real household consumption, quarterly, £ billions, 1997 to 2018**



(Source: adapted from ONS, [www.ons.gov.uk/economy/nationalaccounts/satelliteaccounts/bulletins/consumertrends/apriltojune2018](http://www.ons.gov.uk/economy/nationalaccounts/satelliteaccounts/bulletins/consumertrends/apriltojune2018))

## Extract A

### UK household consumption

Despite the slow growth in real household disposable incomes, consumer spending rose in 2017. Annual spending per person increased by £589, when compared with 2016. This may have reflected UK households' delay in adjusting to the increase in inflation that was associated with the fall in the exchange rate of the British pound. The increase in consumption has also been driven by low interest rates. In 2017 UK house prices increased by an average of 5.1%. 5

UK consumers have financed most of their spending by borrowing on credit cards in order to maintain their living standards. In 2017 borrowing on credit cards rose by 9.6%, the second-highest level since before the financial crisis. This has increased the Bank of England's concerns about the sustainability of borrowing, given the slow growth in real incomes. The Bank has also indicated that the base interest rate was likely to rise faster than previously expected. More expensive credit could therefore constrain the ability of households to spend. 10

(Source: adapted from 'Consumer Trends UK', ONS, <https://www.ons.gov.uk/economy/nationalaccounts/satelliteaccounts/bulletins/consumertrends/octobertodecember2017> and © Crown copyright 2018)

## Extract B

### Reduction of the UK's budget deficit

Since 2010 many economists have believed that the biggest problem facing the government was the rising budget deficit. In late 2017, the UK's Chancellor of the Exchequer announced that the government would continue with its plans to decrease its budget deficit. To address this issue, the government further reduced welfare payments and introduced extra spending cuts in the public sector. 5

The UK government had estimated that the fall in UK productivity since the financial crisis was only temporary. However, it has now accepted that this fall in the level of productivity is a long-term issue. Subsequently, the UK's forecast long-term trend rate of growth was reduced. Slower growth means lower tax receipts, higher spending and a bigger budget deficit. 10

Some economists have suggested that the government should not pursue additional reductions in the budget deficit. They have also claimed that the responsibility of the government is not to balance the budget but to balance the economy by moving it to full employment. 15

(Source: adapted from 'Philip Hammond must ditch deficit reduction and invest. But will he?', The Guardian, <https://www.theguardian.com/politics/2017/nov/19/philip-hammond-must-ditch-deficit-reduction-and-invest-but-will-he>)

7 Evaluate supply-side policies that could be used to increase the UK's rate of economic growth.

(20)

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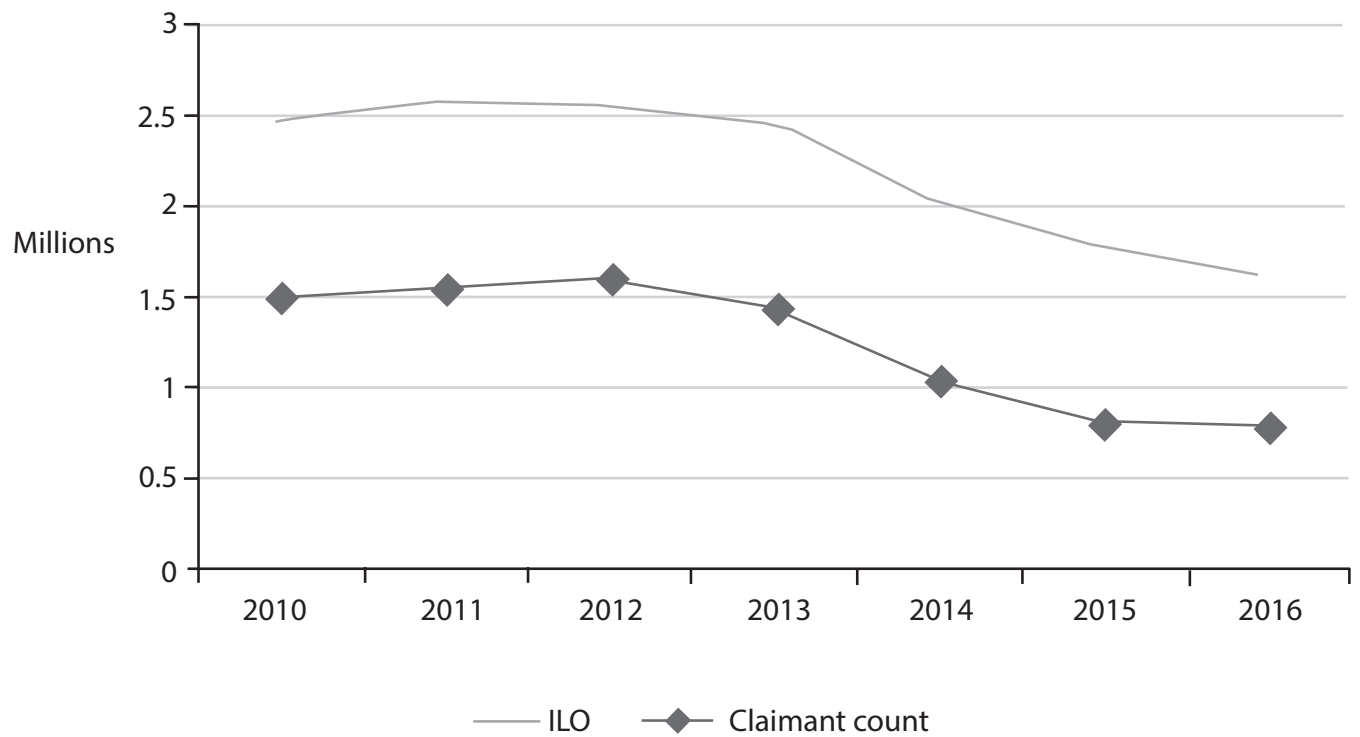
**(Total for Question 7 = 20 marks)**



## Question 8

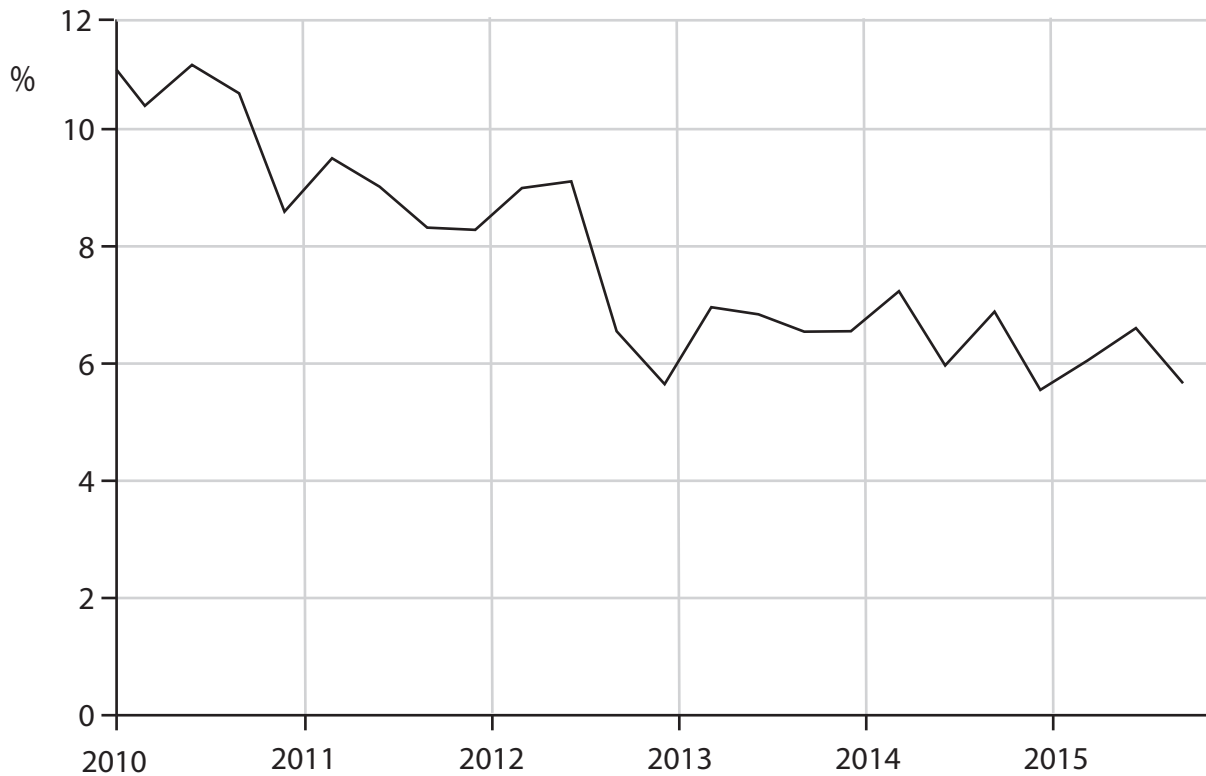
### The UK economy

**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>)

8 Evaluate government policies, apart from migration policies, that could be used to increase the employment rate in the UK.

(20)

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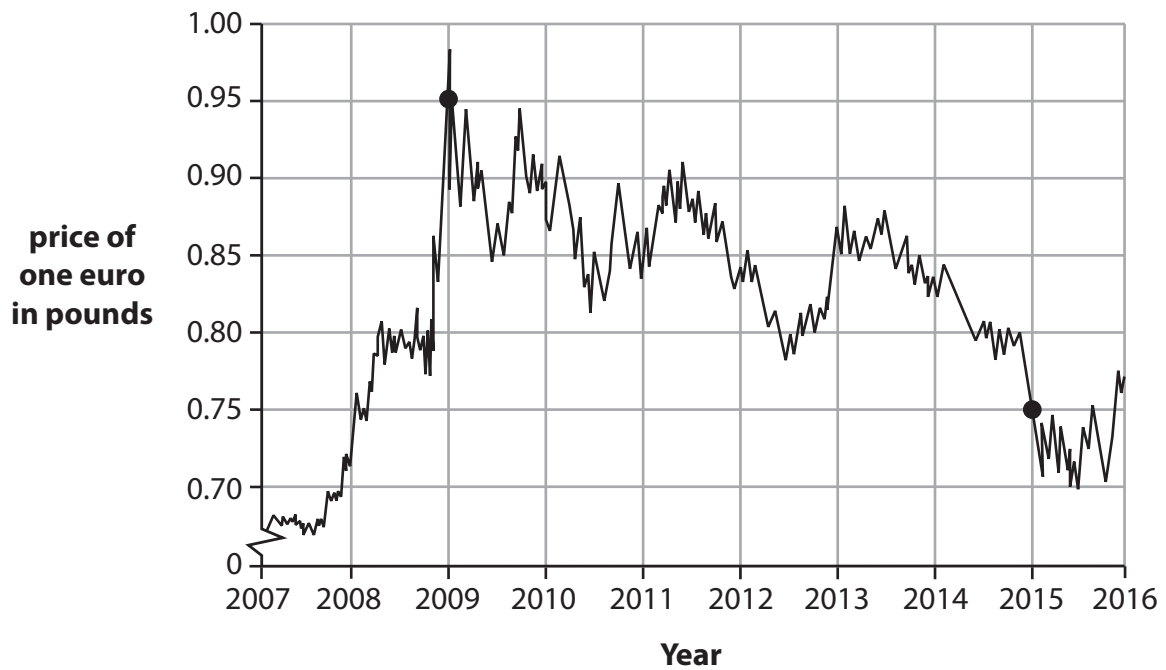
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**(Total for Question 8 = 20 marks)**

## Question 9

### The Eurozone economy

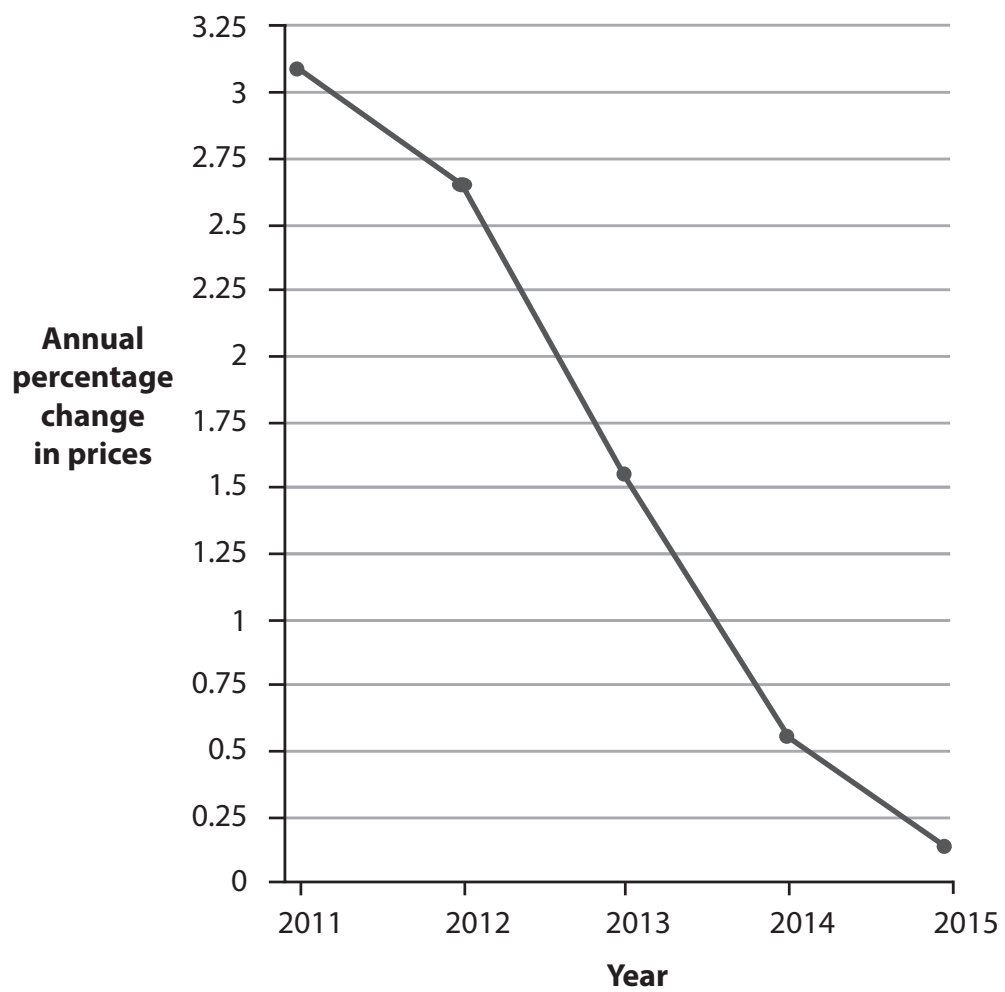
Figure 1: Exchange rate of the euro (€) to the British pound (£)



(Source: <https://www.ecb.europa.eu/stats/exchange/eurofxref/html/eurofxref-graph-gbp.en.html#>)



**Figure 2: Eurozone inflation rate as measured by the Consumer Prices Index (CPI)**



(Source: adapted from <http://www.imf.org/external/pubs/ft/weo/2015/02/weodata/download.aspx>)

## Extract A

### European Central Bank disappoints markets with weaker than expected stimulus

Mario Draghi, president of the European Central Bank (ECB), surprised financial markets in November 2015 with a less ambitious package of monetary stimulus than many had anticipated.

The ECB cut its base interest rate by 0.1% to minus 0.3% in order to encourage private banks to lend funds to companies and households rather than deposit them at the central bank. The central bank agreed to extend its €60 billion (£45 billion) monthly bond-buying quantitative easing (QE) programme for a further six months. The ECB's €1.1 trillion QE scheme had originally been due to end in September 2016. 5

"We are doing more because it works," Mr Draghi said. Yet the ECB did not increase the size of its monthly asset purchases and also disappointed those expecting that it would cut interest rates more aggressively. 10

The euro rose almost 3% against the dollar to \$1.08 after the announcement. Italian and Spanish bond yields both jumped by 0.27% to 1.62% and 1.72% respectively.

The ECB's economists reduced their inflation forecasts for the next two years. They now predict consumer prices in the Eurozone rising by just 1% in 2016 and 1.6% in 2017 – still below the central bank's ceiling of 2%. In November 2015, the inflation rate was just 0.1% and core inflation, excluding volatile items such as fuel and food, dropped to 0.9%. 15

Mr Draghi stressed again that monetary policy alone could not restore the Eurozone to economic health. He called for looser fiscal policy among member states to support aggregate demand and more rapid implementation of supply-side reforms. "In order to reap the full benefits from our monetary policy measures, other policy areas must contribute decisively," he said. 20

(Source: <http://www.independent.co.uk/news/business/news/ecb-disappoints-traders-with-weaker-than-expected-stimulus-a6759786.html>, 4th December 2015)



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**(Total for Question 9 = 15 marks)**

## Question 10

### UK economic recovery

Figure 1: Components of aggregate demand in selected countries 2014

Country	Consumption	Investment	Government spending	Exports - Imports
UK	66%	14%	21%	-2%
Germany	57%	17%	19%	6%
France	57%	20%	25%	-2%
China	34%	49%	14%	3%

**NB: Figures may not add up to 100% due to rounding calculations.**

(Source: World Bank 2014)

**Figure 2: Nominal GDP per capita at Purchasing Power Parities (PPPs)**  
(the base year 2000=100)



(Source: <https://www.imf.org>)



## Extract A

### The UK economy – a strange recovery

At the Autumn Statement in November 2015, the Chancellor of the Exchequer had good reason to cheer his economic record. The UK economy appeared to have returned towards its long-term trend in the rate of economic growth.

GDP growth has remained strong, with output rising at the highest rate in the G7 group of seven major industrialised countries. Unemployment continued to drop and business investment grew by 5%. 5

However, a number of concerns remain, particularly in relation to the UK's current account deficit, which reached a record high of 6% of GDP in the third quarter of 2014. This was primarily a result of a sharp decline in the rate of return on UK investments overseas. Low export growth meant that the UK's trade deficit persisted. 10

In 2012, the Chancellor had announced a target for the UK to export £1 trillion of goods and services by 2020, which would require an annual growth rate of 8%. However, the annual growth in UK exports had reached just 2.7%. The Office for Budget Responsibility (OBR) forecast that UK exports will only reach £630 billion by 2020 – a third lower than the government's target. 15

Exports in services continued to grow in 2015, but the UK's goods industries were struggling. It was particularly concerning that data showed output in the UK's construction and manufacturing industries falling. Indeed, the output of the manufacturing sector remained 6.3% below its pre-recession peak.

Households, meanwhile, are set to become even more indebted over the coming years. It is projected that the household gross debt to income ratio will rise by 26 percentage points between 2015 to 2020, returning to levels last seen before the Global Financial Crisis. The economy did not appear to be rebalancing away from consumer driven growth towards export-led growth, making another recession almost inevitable. 20

Fundamental to this problem is the UK's low productivity, which in 2015 remains around 20 percentage points below the average for the rest of the G7. It is vital that the government tackles this problem, particularly in the sectors that are currently facing difficulties. This will require relaxing the planning system to promote more house-building, the removal of burdens on UK manufacturers such as carbon taxes, finally getting shale gas exploration going, and reforming apprenticeships to rapidly improve skills in construction, manufacturing and technology. 30

(Source: adapted from <http://www.cityam.com/229481/chancellor-beware-uk-not-out-woods-yet>, 25 November 2015 by Daniel Mahoney)

**10** Evaluate policies the government could use to increase the UK's productivity.

**(15)**

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(Total for Question 10 = 15 marks)

## 11 UK inflation

Figure 1 UK Consumer Prices Index (CPI) inflation, year on year



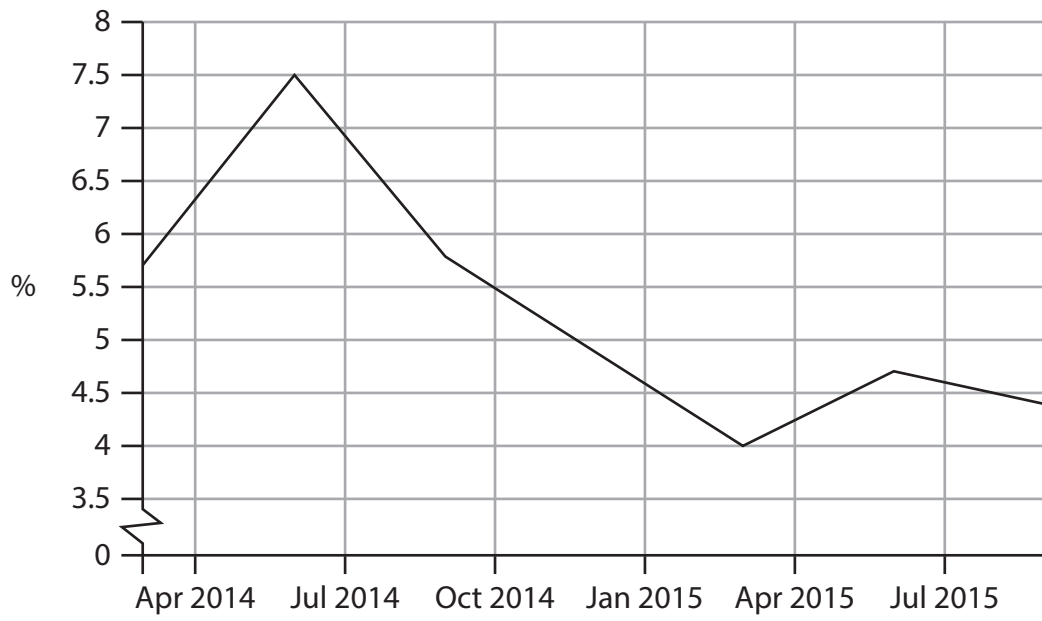
(Source: [http://www.ons.gov.uk/ons/dcp171780\\_427182.pdf](http://www.ons.gov.uk/ons/dcp171780_427182.pdf))

Figure 2 Oil price (\$) per barrel



(Source: <https://www.tradingview.com/chart/?symbol=FX:USOIL>)

**Figure 3 UK savings ratio (percentage of disposable income saved by households)**



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

## Extract 1 UK prices

Deflation (fall in average price level) can cause concern. For the second time in 2015, the UK economy has slipped into deflation. But it is nothing to worry about. This is 'good' deflation, not bad.

Deflation is bad when it is the result of less money in the economy, meaning consumers are buying fewer products and services and firms are cutting prices in a bid to stimulate demand. This can lead to worsening company performances, cost cutting and redundancies. Less spending means lower demand, which damages economic growth. 5

Worse still is the potential for a deflationary spiral – where people hold on to their money rather than spend it because they think it will be worth more in the future. This reduces aggregate demand, in turn pushing prices down further, so people hang on to their money for longer. Breaking this spiral can be difficult to achieve. 10

But we do not have to worry about that yet. Here is why the UK is experiencing good deflation.

- **Falling commodity prices**

An excess supply of oil has driven down its price. This has had a positive knock-on effect on many businesses in the form of lower costs. In the retail sector in particular, prices are lower because goods are cheaper to manufacture and transport. Also lower petrol prices have eased the pressure on drivers' wallets. Many commodity prices have fallen, from oil to agricultural produce to metals. Often, these lower prices are passed on to the consumer – which pulls down inflation. 15 20

Falling food and fuel prices have boosted the spending power of households across the country and businesses can spend less on moving goods and people across the world and more on paying down debt, investing in equipment, hiring staff or offering pay rises.

- **Real wage growth is stronger and consumers are still spending money** 25

For much of 2015, CPI inflation has been at or very close to 0%. At the same time, wage growth excluding bonuses, rose to 2.9% over the year, according to the ONS. Previously, real wages had been in decline, so this is a welcome reversal. If consumers were not spending, we would be worried. But amid record high employment levels and real wage increases, consumer spending is on the rise while the household savings ratio is falling. 30

- **Inflation has been stable and is set to rise soon**

Investec Economics, an investment bank, reported: "The inflation rate has remained remarkably stable in recent months: today's data marks the eighth month running where the inflation rate has remained fairly steady within the -0.1% to +0.1% range. During this period, we have not seen a worrying change in inflation expectations." 35

- **It gives the Bank of England breathing space on interest rates**

Policymakers at the Bank of England are juggling when best to raise the base rate from its all-time low of 0.5% as the economy recovers from the financial crisis. This is to stop people taking excessive advantage of cheap credit in a booming economy, which would carry substantial financial risks. But the Bank of England must target 40



a 2% inflation rate over the medium term. So if it raises interest rates, it will cost more to borrow money – so less of it will make its way into the economy.

Most households and businesses have debts. When interest rates rise, repayment costs on these debts will also go up, leaving less to spend or save.

45

(Source: adapted from <http://www.ibtimes.co.uk/uk-inflation-why-this-good-deflation-1523810>)

**\*11** Evaluate policies that could be used to return the UK's inflation rate to its 2% target.

(30)

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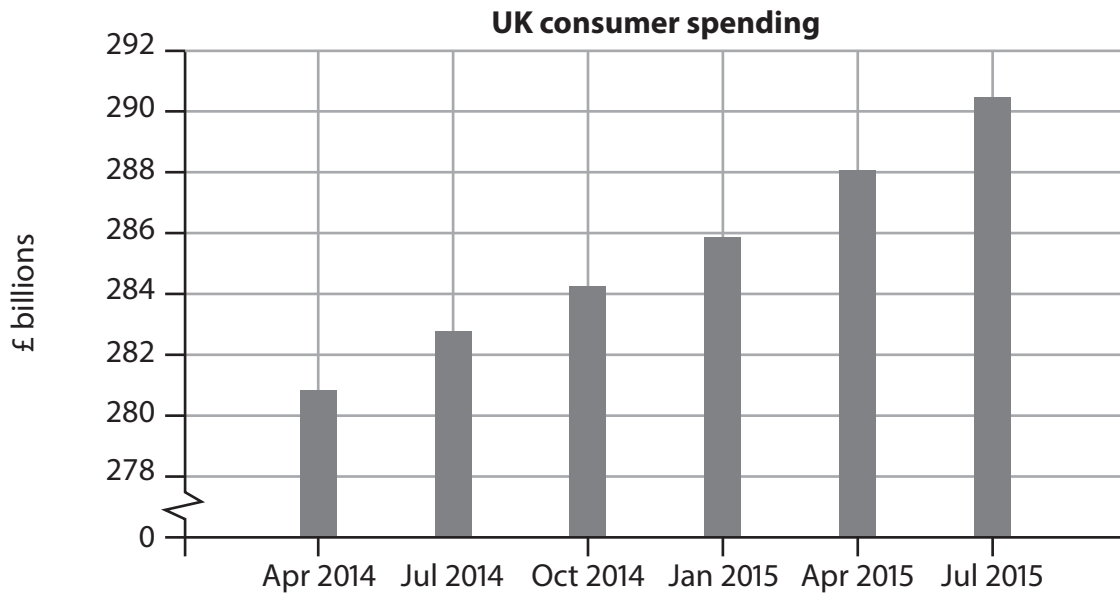
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**(Total for Question 11 = 30 marks)**

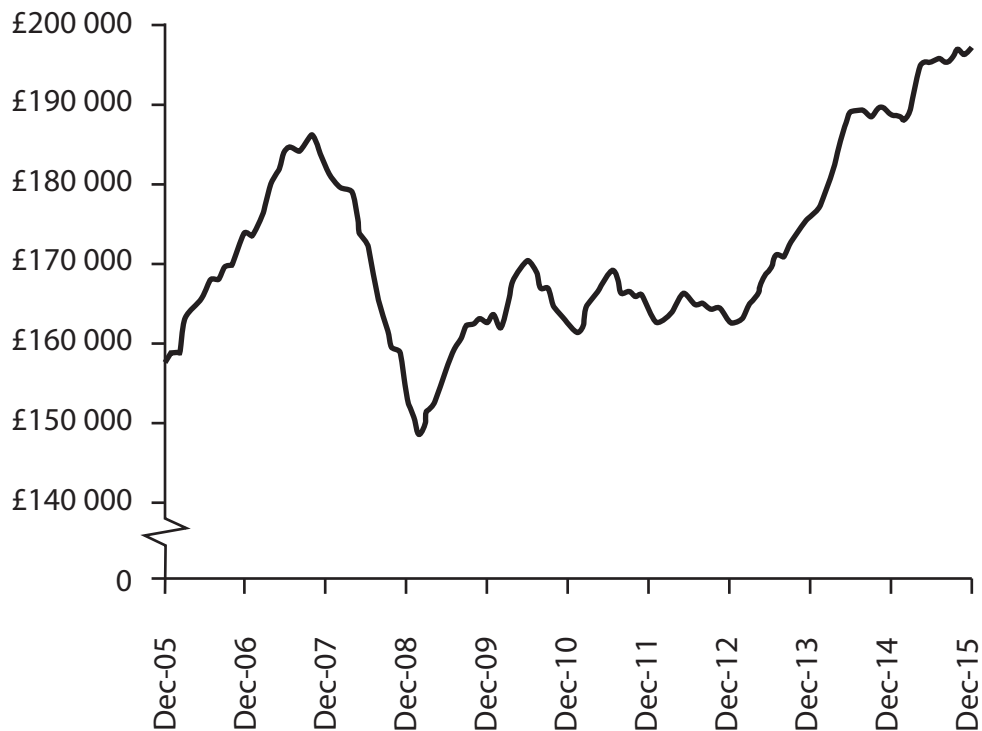
## 12 Stability of the UK economy

Figure 1 UK nominal consumer spending by quarter (£ billions)



(Source: <http://www.tradingeconomics.com>)

Figure 2 Average UK house prices December 2005 - December 2015



(Source: <http://www.nationwide.co.uk/~media/MainSite/documents/about/house-price-index/Dec-Q4-2015.pdf>)

## Extract 1 Warning over rising household debt

Britain risks becoming dependent on rising consumption fuelled by household debt as factory output and exports fall, MPs have been told. SNP economics spokesman Stewart Hosie issued the warning after figures showed that household debt has increased substantially since summer 2015 while manufacturing output turned in its worst performance since 2013.

5

Mr Hosie said Chancellor George Osborne was failing to keep his promise to make exports a significant contributor to growth in order to rebalance the economy away from household consumption.

The rising debt figures, with average family debt now at £13 520, are inconsistent with a rebalanced economy, he suggested. These figures are being further fuelled by low interest rates and rising incomes.

10

Mr Hosie said: "The key thing about the impact of trade and exports on GDP is that it is negative. As we saw in the reports yesterday, because industrial output is down and exports are likely to continue to fall, we are going to continue to see or need a dependence on household consumption and a rise in household debt which would be inconsistent with a properly rebalanced economy."

15

Mr Hosie said that many jobs depend on thriving manufacturing exports and he criticised the Chancellor for setting an "unachievable" target of doubling exports to £1 trillion by 2020. Instead, exports fell from £521 billion in 2013 to £513 billion the following year, and the independent Office for Budget Responsibility said Mr Osborne's target would be missed by £350 billion.

20

Mr Hosie said encouraging more innovation would prove key in boosting manufacturing – which still accounts for 44% of all UK exports. "That is as much a part of building a larger, more productive and faster growing manufacturing base as it is important in its own right."

25

Mr Hosie criticised plans to change the funding model of the Government's innovation agency, Innovation UK. He said £165 million of grants for innovation will now be turned into loans, which may suppress innovation even further. He argued that it was important to encourage innovation because as it had declined, so had manufacturing output, exports and employment.

30

Labour Party spokesman Bill Esterson commented that the UK spent less on research as a share of GDP than France, Germany, the US and China. There was also, he said, "slow progress" in infrastructure projects and the quality of infrastructure was now the second worst in the G7, the group of leading industrialised nations, adding "capital spending has more than halved as a proportion of GDP since 2010".

35

The problem of UK exports, he added, was made worse by low productivity. ONS statistics showed that, in 2014, productivity measured as output per hour worked in the UK was 21% lower than the average for the rest of the G7 countries.



Mr Esterson proposed encouraging small businesses, looking to export for the first time, to work together with other firms who are already successfully exporting. "I think that that would be really helpful because I think... having to deal with all the VAT, National Insurance, marketing, manufacturing – that is actually quite frightening for a small company and I think that is what is so off-putting."

40

(Source: adapted from: <http://www.heraldscotland.com/news/homenews/14201611>.  
Stewart\_Hosie\_issues\_warning\_over\_rise\_of\_household\_debt/)

**\*12** Discuss policies that could be used to improve the productivity of the UK economy.

(30)

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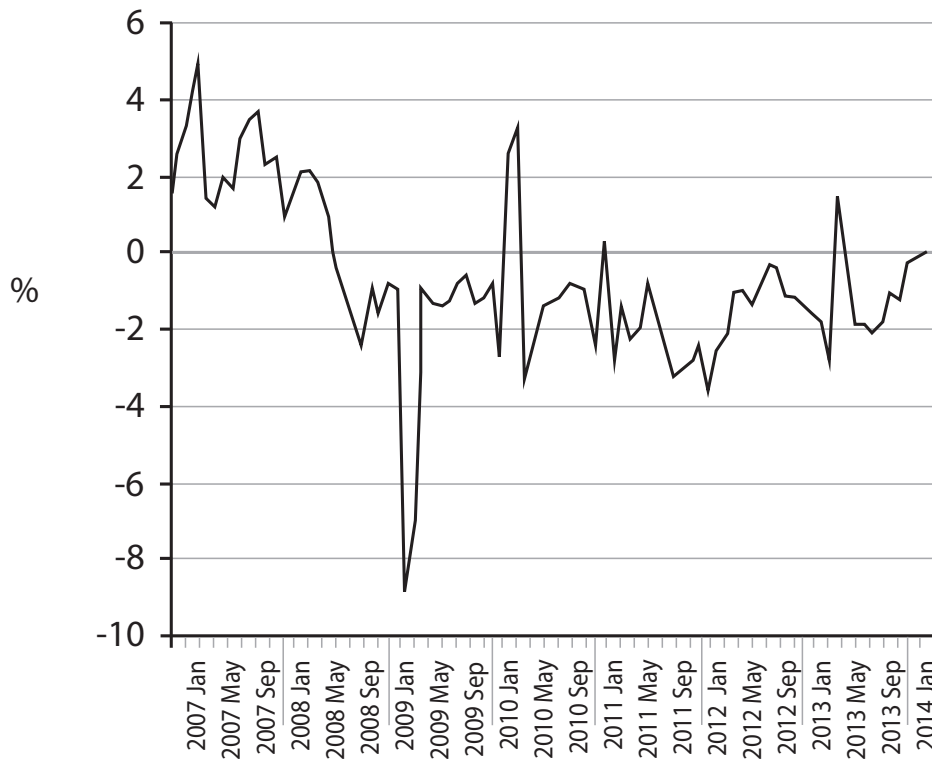
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**(Total for Question 12 = 30 marks)**

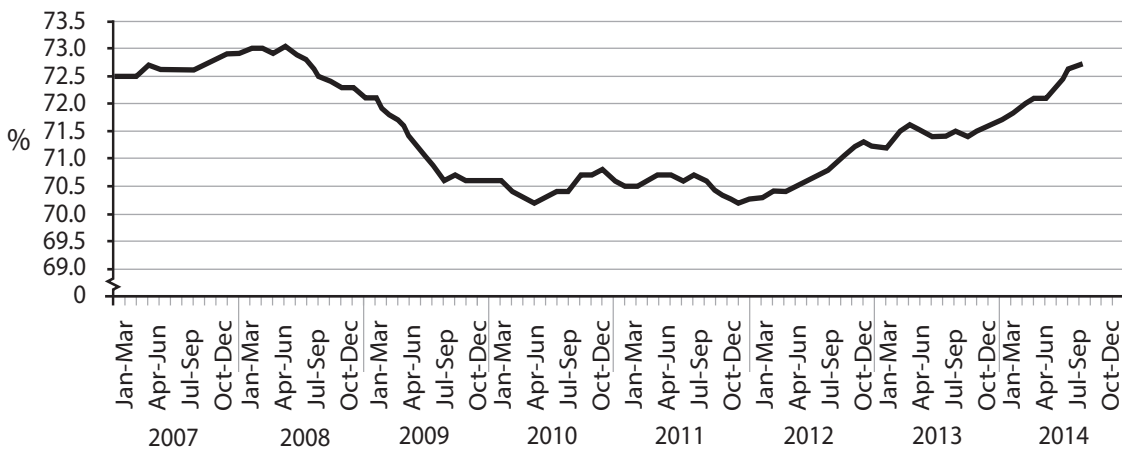
### 13 UK wages, employment, migration and the trade deficit

**Figure 1 Real wage growth, per cent change on the same month a year ago**



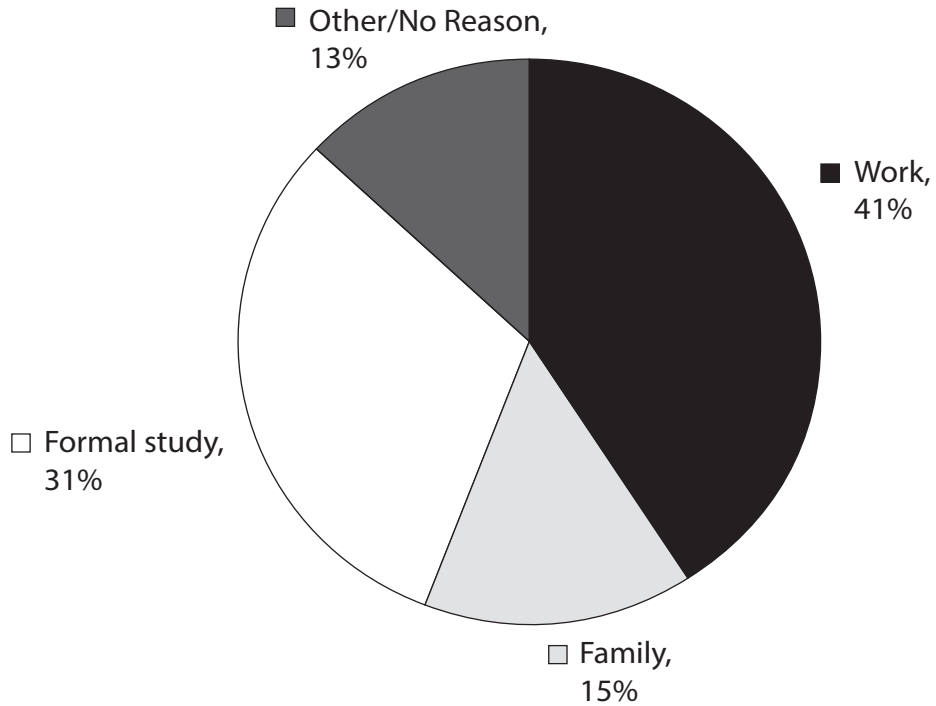
(Source: © ONS Economic Review June 2014, [http://www.ons.gov.uk/ons/dcp171766\\_365818.pdf](http://www.ons.gov.uk/ons/dcp171766_365818.pdf))

**Figure 2 UK employment rate, % of 16–64 age group**



(Source: © ONS Economic Review June 2014, [http://www.ons.gov.uk/ons/dcp171766\\_365818.pdf](http://www.ons.gov.uk/ons/dcp171766_365818.pdf))

**Figure 3 Main reason for immigrating to UK, year ending March 2014**



(Source: © ONS Migration Statistics Quarterly Report, August 2014, [http://www.ons.gov.uk/ons/dcp171778\\_375307.pdf](http://www.ons.gov.uk/ons/dcp171778_375307.pdf))

**Extract 1 Migration trends**

- Net long-term migration to the UK was estimated to be 244 000 in the year ending March 2014, an increase from 175 000 in the previous 12 months.
- 560 000 people immigrated to the UK in the year ending March 2014, an increase from 492 000 in the previous 12 months.
- An estimated 316 000 people emigrated from the UK in the year ending March 2014. Long-term emigration has been relatively stable since 2010.
- There was an increase in immigration for work (up 38 000 to 228 000).

5

(Source: adapted from © ONS Migration Statistics Quarterly Report, August 2014, [http://www.ons.gov.uk/ons/dcp171778\\_375307.pdf](http://www.ons.gov.uk/ons/dcp171778_375307.pdf))



## Extract 2 Trade deficit widens

The UK's trade position deteriorated unexpectedly in July 2014 after imports increased more than exports, frustrating the Coalition Government's ambitions to rebalance the economy. The trade in goods deficit widened to £10.2 billion from £9.4 billion in June 2014. It almost matched the largest monthly deficit on record. The broader trade in goods and services deficit also widened in July 2014, to £3.3 billion from £2.5 billion in June 2014. The Office for National Statistics data showed a larger goods deficit in July 2014 driven by a £1.3 billion rise in imports to £34.2 billion, outpacing a £0.5 billion increase in exports to £24 billion. 5

In 2012, the Government set a target of doubling UK exports to £1 trillion by 2020 as part of a broader ambition to rebalance the economy away from consumer spending and towards manufacturing and exports. However, exports increased by just 2.1% in 2013 to £505.6 billion, and this target is looking increasingly challenging. With the eurozone economy remaining weak and ongoing unrest in Eastern Europe and the Middle East, export growth is likely to remain low in the short term. 10

Exchange rates are of particular concern for UK trade, according to Martin Beck, a senior economic advisor: "With around 45% of UK manufactured goods exported, overseas sales are key for continued growth in the sector. The recent fall in the value of sterling should, temporarily, boost prospects for UK exporters." 15

(Source: adapted from © Guardian Newspaper Ltd., September 2014, <http://www.theguardian.com/business/2014/sep/09/uk-trade-deficit-widens-unexpectedly>)

**\*13** Evaluate government policies that could be used to increase the employment rate in the UK.

(30)

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(Total for Question 13 = 30 marks)

## 14 UK investment, productivity and the balance of payments

Figure 1 UK business investment (£bn at 2010 prices)

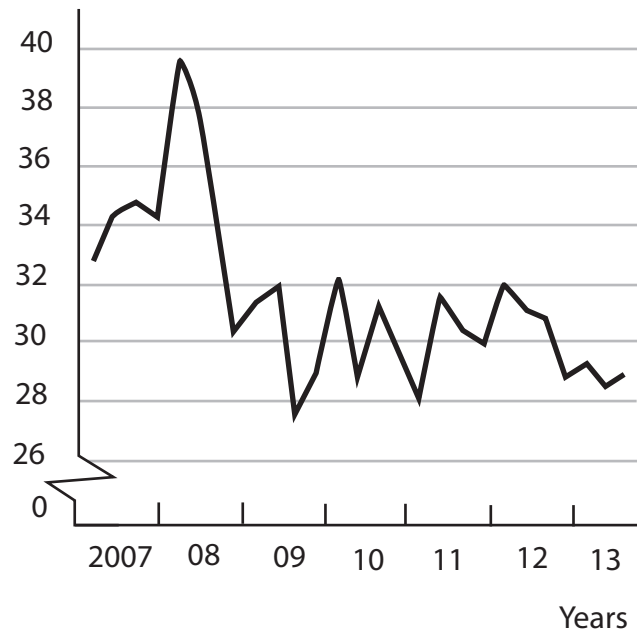
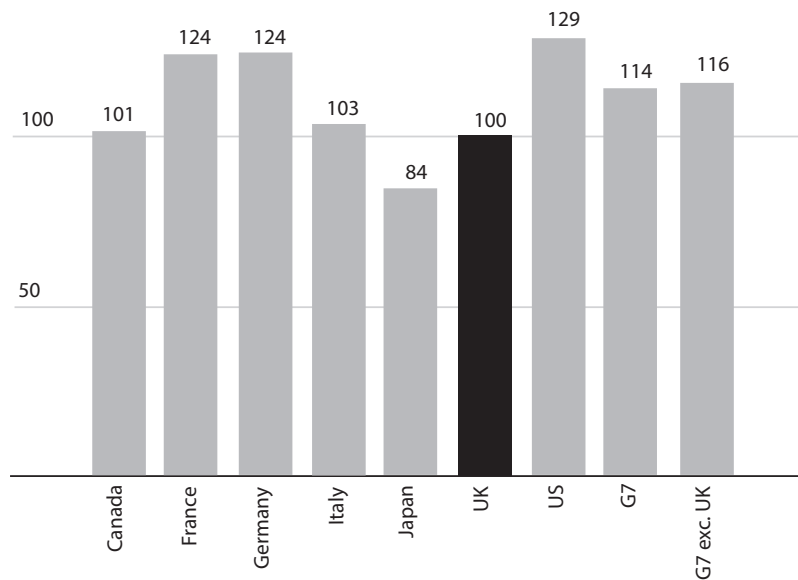
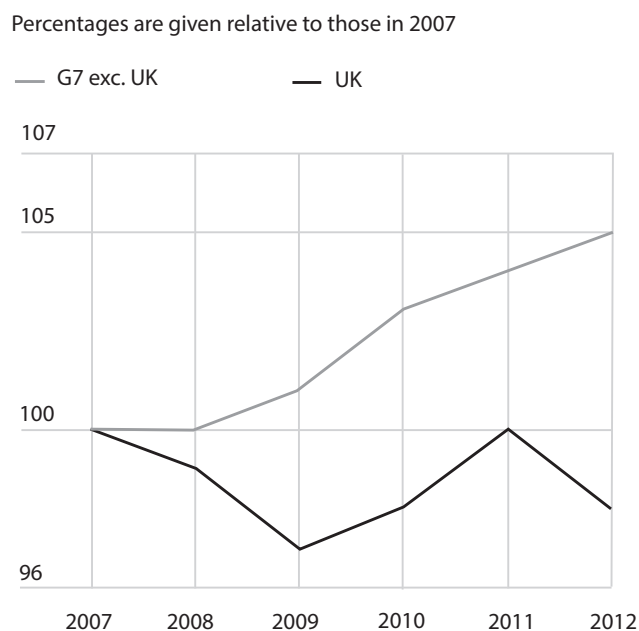


Figure 2 GDP per hour worked relative to the UK in 2012



(Source: <http://www.theguardian.com/news/datablog/2013/sep/18/uk-workers-less-productive-ons>)

**Figure 3 Productivity per hour worked (GDP) since 2007**



G7 countries: USA, UK, France, Germany, Italy, Canada and Japan

(Source: <http://www.theguardian.com/news/datablog/2013/sep/18/uk-workers-less-productive-ons>)

**Figure 4 Current account of the UK's balance of payments as a percentage of GDP at current market prices**

Year	% of GDP
2002	-2.1
2003	-1.7
2004	-2.0
2005	-1.8
2006	-2.8
2007	-2.2
2008	-0.9
2009	-1.4
2010	-2.7
2011	-1.5
2012	-3.8

(Sources: <http://www.ons.gov.uk/ons/rel/bop/united-kingdom-balance-of-payments/2013/index.html> and <http://www.theguardian.com/business/2011/sep/20/uk-productivity-falls-behind-competitors>)



## Extract 1 Productivity gap between UK and the other G7 nations widens to largest in 20 years

Deep recession and slow recovery have widened Britain's productivity gap with the other rich G7 nations to its largest since 1994, according to official figures.

Data from the Office for National Statistics (ONS) showed that the output per hour from UK workers in 2012 was 2% down on its pre-slump levels in 2007 and 16% below the average of other leading industrialised nations. 5

The ONS said that output per hour worked in Britain was 29% lower than in the US and 24% lower than in Germany and France. Canada and Italy had slightly higher productivity than the UK and only one G7 nation – Japan – had a worse record.

Britain's gross domestic product is still below its peak reached in 2008, but despite the deepest recession of modern times, the shake-out in the labour market was less severe than in the downturns of the 1980s and 1990s. The combination of weak output and a willingness of workers to accept pay cuts to keep their jobs has resulted in a poor productivity record. 10

The ONS said that the gap with the rest of the G7 was even wider – 19% – using an alternative measure of productivity, output per worker. 15

John Philpott, Director of The Jobs Economist, said: "The relative improvement in the UK's productivity performance from the mid-1990s to the late 2000s has clearly gone into reverse in an economy reliant on falling real wages, rather than increased output, as the main driver of employment growth. According to the ONS output per hour in 2012 would have been 15 percentage points higher had the pre-recession rate of growth been maintained. Though some of this latter growth may have been 'illusory', in that it was propelled by an unsustainable boom, the UK economy clearly needs, in particular, a strong resurgence of business investment in order to regain its pre-recession productivity mojo." 20

The Bank of England is assuming that Britain's productivity will improve as demand recovers, although opinions differ about how much of the shortfall is caused by permanent damage from the recession. 25

Howard Archer, Chief UK Economist at IHS Global Insight, said the ONS's international comparisons made "very uncomfortable reading." He added: "An element of the UK's poor productivity performance does appear to have been companies' willingness to hold on to workers, particularly when the workers are skilled or experienced. There have also been reports that some companies employed more people, or at least retained workers, as they found winning and delivering work more resource-intensive in an environment of persistently weak demand." 30

(Source: adapted from <http://www.theguardian.com/business/2013/sep/18/productivity-gap-uk-g7-output>)

**\*14** Evaluate the use of supply side policies in raising the level of real output in the UK economy.

(30)

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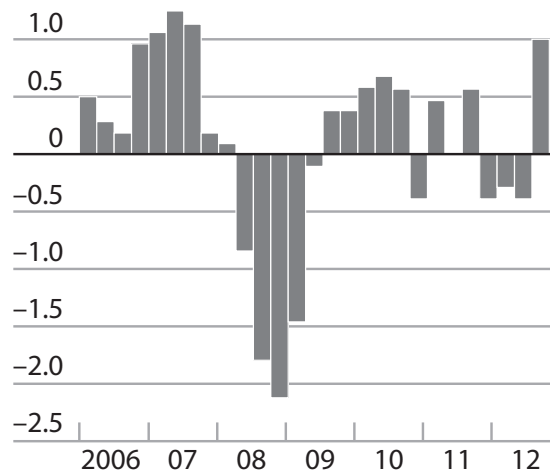
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**(Total for Question 14 = 30 marks)**

## 15 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.

10

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.

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

**\*15** With reference to the information provided and your own knowledge, evaluate the policies that the UK government could adopt to improve productivity.

**(30)**

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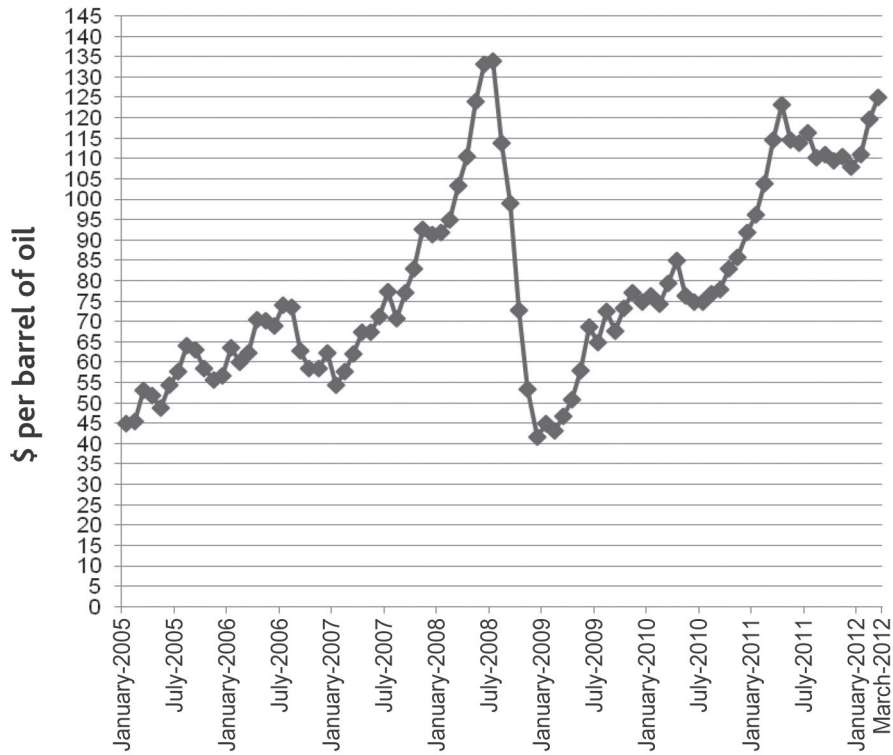
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(Total for Question 15 = 30 marks)

## 16 Balance of payments, Inflation and Investment

Figure 1 Oil price (Brent Crude Oil), US dollars per barrel from January 2005 to March 2012



(Source: adapted from © Financial Times, May 3rd 2012)

## Extract 1 The deficit on the current account of the balance of payments continues into the first quarter of 2012

When sterling's exchange rate fell 25% between mid-2007 and early 2009, economists thought that this would reduce the deficit in the trade of goods and services on the current account of the balance payments and boost the UK's economic growth. They were only half right. Exports of British goods have indeed recovered from the depths of recession – volumes are up 21% since 2009 – and a recent survey of manufacturers suggested activity expanding at a healthy pace. However the volume of goods imported has also increased, by 16% since 2009, and inflation has continued well above target. 5

David Blanchflower, a former member of the Bank of England Monetary Policy Committee, said: "We underestimated the uplift to inflation from the depreciation ... but we probably overestimated the positive effect of UK manufacturers replacing imports." In a recent paper, two Bank of England economists tried to explain these inaccurate estimates. Perhaps, they suggested, after the long contraction of UK manufacturing, some goods are no longer made in the UK, so it is impossible to replace certain imports. British manufacturers have almost entirely abandoned some markets, particularly those for products that are labour intensive. In 1997, for example, UK producers made 16% and 22% respectively of all the leather goods and clothing sold in the country. In 2009, these market shares had fallen to 6% and 8%. 10 15

Manufacturing goods in the UK also often necessitates importing raw materials, components and capital goods. This dependency on overseas suppliers is partly explained by the fact that many manufacturers agreed long-term supply contracts with cheaper overseas suppliers before the depreciation of sterling. 20

The Bank of England economists also noted there is still a large price differential with countries such as China and India, even after sterling's depreciation. Furthermore, many UK manufacturers learnt long ago to compete on brand and quality rather than price, which can mean that big changes in the exchange rate have little effect on sales. 25

However, there are hints that things might start to change as the lower exchange rate and other factors have an impact on strategic decisions. Many manufacturers are discussing bringing parts of their production home because of high wage inflation in emerging markets, the desire for more responsive supply chains and lower shipping costs. 30

(Source: adapted from © Financial Times, April 3rd 2012)

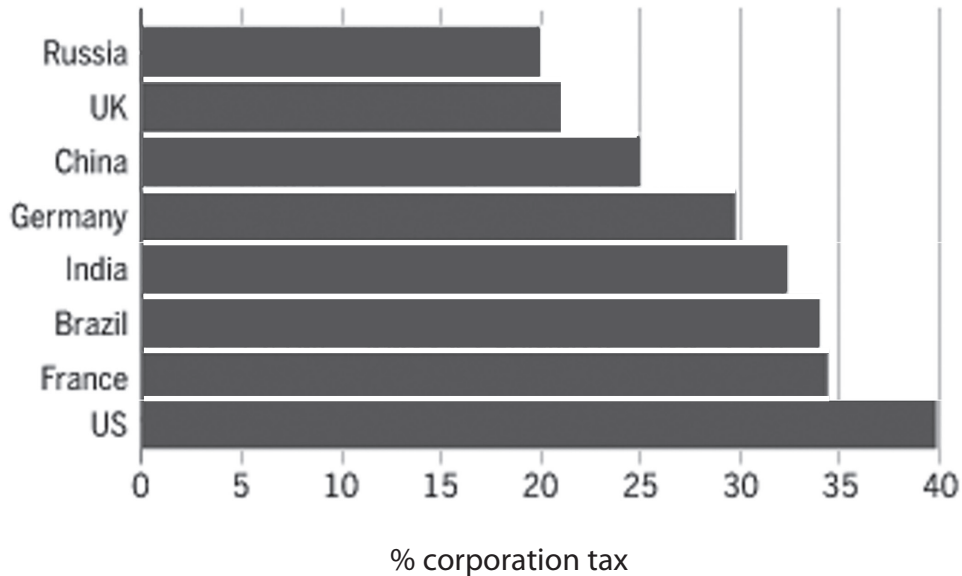
## Extract 2 Business Investment and Corporation tax

Business investment as a share of GDP fell from nearly 13% in 2000 to below 8% in 2011 and surveys of business confidence are pessimistic. The previous government reduced corporation tax – a tax on company profits – from 30% to 28% in 2008. The current Chancellor is gradually reducing it further to 21% by 2014, which he hopes will increase investment by between 5% and 10% per annum during 2013–16.

5

(Source: adapted from © Crown copyright)

**Figure 2 Main corporation tax rate (%) planned for 2014 (selected G20 and G7 countries)**



(Source: © Financial Times, 21 March 2012)



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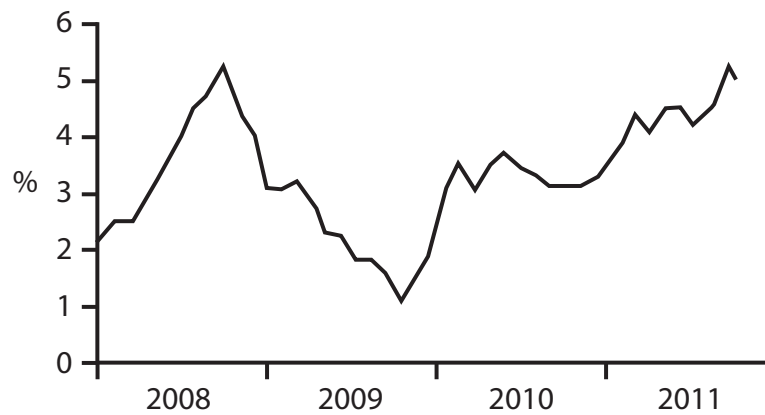


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(Total for Question 16 = 30 marks)

## 17 Inflation and the Standard of Living

**Figure 1 UK rate of inflation (annual percentage change as measured by the CPI)**



### **Extract 1 The UK rate of inflation falls**

A supermarket price war, cheaper air fares and lower petrol prices caused inflation to slow to 5% in October 2011, ending its recent upward trend and prompting economists to predict it will fall sharply in 2012. The annual increase in the consumer price index peaked at 5.2% in September 2011. With the cost of petrol, food and air travel all dropping in October, having risen in the same month in 2010, the overall rate of inflation was pushed down. 5

Even though the rate of inflation has begun to fall as economists had expected, the annual rate remains well above the Bank of England's 2% target, prompting another letter of explanation from Sir Mervyn King, Governor of the Bank of England, to George Osborne, Chancellor of the Exchequer. In November 2011, Sir Mervyn wrote that "inflation will fall back sharply in the next six months or so and continue falling thereafter to around target by the end of next year". 10

He could make the prediction because large price rises that occurred towards the end of 2010 were beginning to drop out of the inflation calculation, since they happened over a year previously. The rate of inflation would fall sharply as this process accelerated in early 2012 once the rise in value added tax to 20% no longer counted in the measure. 15

Even though Sir Mervyn pointed to lower inflation in the future, the average rate tolerated by the Bank of England over the previous four years had been 3.5%, far above the 2% target.

He said the Bank had used low interest rates and monetary expansion ('quantitative easing') to aid the economy's adjustment to higher energy and import prices. Without these policies, the economy would have been more vulnerable to a recession. 20

(Source for Figure 1 and Extract 1: adapted from 'Supermarket price war eases inflation', © Financial Times, 15 November 2011)

**Figure 2 Selected data on living standards**

	Human Development Index (HDI) 2011	Gross National Income per head 2011 (Constant 2005 PPP \$)
Germany	0.905	34,854
Spain	0.878	26,508
United Kingdom	0.863	33,296
Fiji	0.688	4,145
China	0.687	7,476
Ethiopia	0.363	971

(Source: Data retrieved from the UNDP Human Development Report website: <http://hdr.undp.org/en/statistics/> © UNDP)

\* (a) With the aid of an aggregate demand and aggregate supply diagram, assess the possible effects on the UK economy of an increase in government expenditure on education.

(12)

A series of horizontal dotted lines provided for the student to draw an aggregate demand and aggregate supply diagram and write their assessment.

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\*(b) Other than investing in education, evaluate policies a government can implement to raise living standards.

(30)

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**(Total for Question 17 = 42 marks)**

## 18 Real Income and Unemployment

### Extract 1 UK households' real disposable incomes

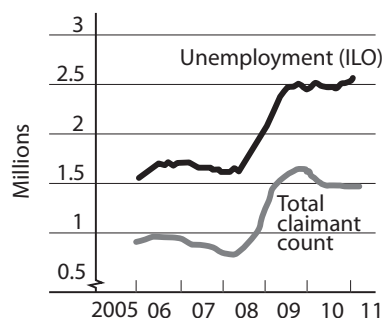
New GDP figures show real household disposable incomes falling by 0.8% in 2010. This is the first time the measure has fallen since 1981.

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)

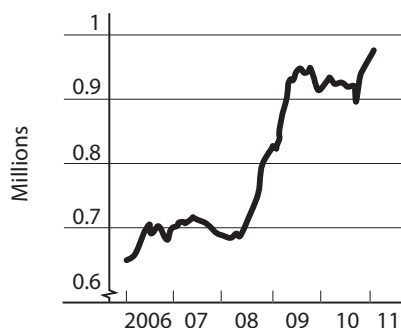
### Extract 2 Unemployment measurements diverge

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)

**\*18** Evaluate macroeconomic policies which may be used to reduce the level of unemployment in the UK.

**(30)**

A series of horizontal dotted lines for writing the answer.

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**(Total for Question 18 = 30 marks)**



## 19 Inflation and Unemployment in the UK

**Figure 1 Selected changes to the CPI basket of goods and services, 2010**

IN	OUT
Cereal Bars	Hairdryer
Fruit drink in a bottle	Fizzy canned drink
Blu-ray disc players	Disposable camera
Lip gloss	Lipstick

<http://www.guardian.co.uk/news/datablog/2010/mar/15/inflation-basket>

### **Extract 1 King says inflation surge 'short term'**

When inflation, measured by the Consumer Price Index (CPI), moves outside the tolerance of 2% + or – 1%, the Governor of the Bank of England is required to write an open letter to the Chancellor explaining the reasons for it. In February 2010 CPI inflation reached 3.5%.

In his February letter the Governor, Mr King, pointed to three factors: the rise in VAT back to its pre-recession 17.5% rate, a sharp increase in oil prices of roughly 70% over the past year, and the sharp depreciation of sterling in 2007 and 2008. 5

However, Mr King also stressed that inflation might eventually fall below target because of the sharp fall in consumer and investment spending and the build-up of spare capacity in the economy as labour, factories and equipment lie idle. 10

He noted that the Monetary Policy Committee (MPC) has already cut interest rates to 0.5% and the Bank of England has bought £200 bn of government bonds to encourage the commercial banks to increase lending.

Source: Based on the following articles in the FT "King says inflation surge 'short term'" by Norma Cohen published on February 16 2010 and "Farewell to QE" by Lex on 4 February 2010

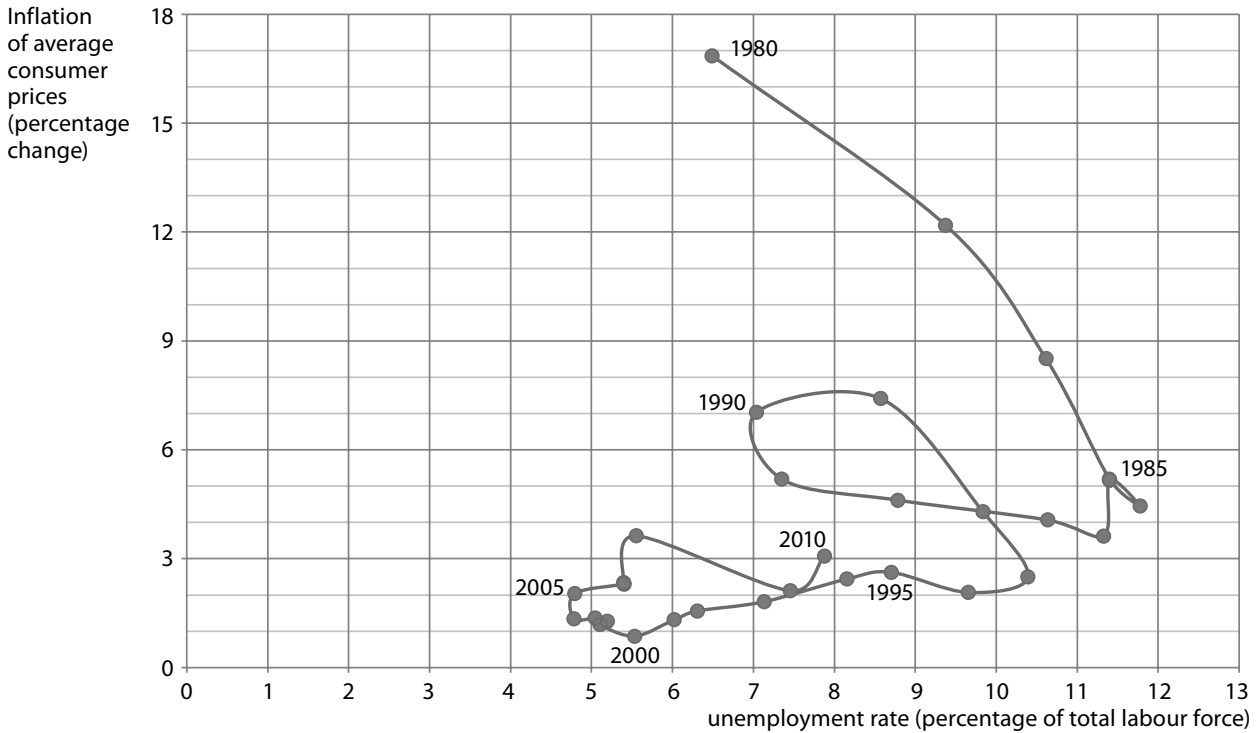
<http://www.ft.com/cms/s/0/d29d8984-1aea-11df-88fa-00144feab49a.html> and  
<http://www.ft.com/cms/s/3/3963580c-1199-11df-9195-00144feab49a.html>

### **Extract 2 Unemployment Headlines from the Guardian, March 2010**

- Claimant count falls to 1.59 million people
- Labour Force Survey measure falls 33,000 to 2.45 million people
- But 'economically inactive' people rises to record 8.16 million
- Youth unemployment (16–25) reached over 20% (1 million)
- Employment level hits lowest since 2006 5

<http://www.guardian.co.uk/business/2010/mar/17/unemployment-fall-raises-recovery-hopes>

**Figure 2 UK Inflation and Unemployment 1980–2010\***



\*The 2010 figure is predicted

Source: <http://www.imf.org/external/pubs/ft/weo/2010/02/weodata/index.aspx>

**Figure 3 United Kingdom Unemployment rate by duration (annual data from the Labour Force Survey)**

Date	Unemployed for less than one year %	Unemployed for more than one year %	Total %
2004	3.8	1.0	4.8
2005	3.9	1.0	4.9
2006	4.2	1.2	5.4
2007	4.1	1.3	5.4
2008	4.3	1.4	5.7
2009	5.8	2.0	7.8

Source: <http://www.bankofengland.co.uk/publications/inflationreport/ir10feb3.xls>

**\*19** Discuss the fiscal and supply side policies the UK Government could pursue to reduce the rate of unemployment. Refer to Extract 2 and Figure 3 in your answer.

(30)

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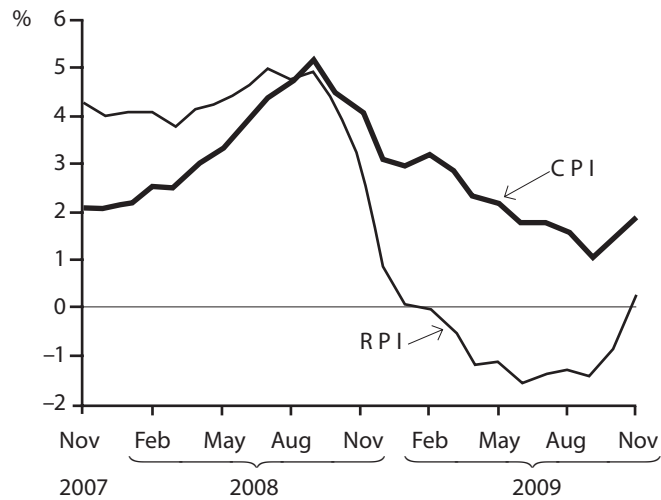
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**(Total for Question 19 = 30 marks)**

## 20 Inflation and growth

**Figure 1 Rates of Inflation in the UK, year on year percentage changes**



Source: <http://www.statistics.gov.uk/pdfdir/cpi1209.pdf> produced on 15th December 2009.

**Figure 2 Annual percentage change in Gross Domestic Product (GDP) at constant prices**

				Forecast
Country	2007	2008	2009	2010
Germany	2.5	1.2	-5.0	1.2
United Kingdom	2.6	0.5	-4.9	1.3
United States	2.1	0.4	-2.4	3.1
Developing Economies	8.3	6.1	2.4	6.3

Source: [www.imf.org](http://www.imf.org) (World Economic Outlook Database April 2010).

### Extract 1 Recession to cause permanent damage

The effects of the 2008-09 financial crisis and recession (at least two consecutive quarters of negative growth) has similarities to the recessions of the 1920s, 1980s and 1990s: global output is on a persistently lower path than expected before the crisis; public finances are severely weakened; long term unemployment has increased and income inequality has risen.

5

Research by the International Monetary Fund (IMF) into previous recessions found three major forces which tended to prevent economies rebounding to their pre-crisis trends of output.

First, for a period of time after the recession there is likely to be high unemployment and misallocations of resources in several sectors of the economy. An example is residential construction. If unemployment remains high for some time, former employees may lose skills and the discipline of working.

10

Second, part of the capital stock is destroyed as some plant and equipment is scrapped prematurely. Other companies struggle to invest in viable and innovative projects because banks restrict credit to protect their finances.

15

Third, productivity falls because there is 'less innovation, as research and development spending tends to be scaled back in bad times', the IMF says.

Source: adapted from *The Financial Times*, the article 'Recession to leave permanent scars' by Chris Giles, 24th November 2009.



**\*20** Assess the effectiveness of supply-side measures that the government could use to deal with the problems outlined in paragraphs 3, 4 and 5 of Extract 1.

**(30)**

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**(Total for Question 20 = 30 marks)**

## 21 Monetary Policy

### Extract 1 MPC agreement on rates freeze

All nine members of the Bank of England's Monetary Policy Committee (MPC) voted in favour of freezing interest rates at an historic low of 0.5 per cent, according to the minutes of their April 2009 meeting. The MPC has aggressively cut the cost of borrowing from 5 per cent to 0.5 per cent since October 2008 in an effort to stimulate UK economic growth.

5

Policy makers noted that the prospect of households holding back on spending was probably the biggest risk to an economic recovery. Household consumption fell by 1 per cent in the fourth quarter of 2008 and the ratio of savings to disposable income was higher than expected.

Since then, developments in household spending have been more encouraging. Data on retail sales and car registrations have suggested a slowdown in the rate of decline of consumption. There are indications that confidence and affordability in the housing market are improving, although from very low levels, in the first quarter of 2009. Nevertheless, it is too soon to be sure whether a more significant recovery in consumers' expenditure is in prospect.

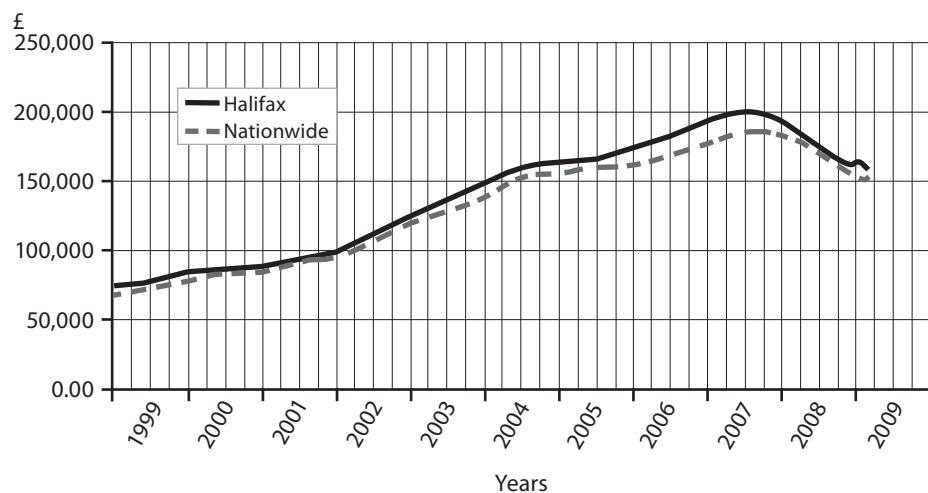
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The Committee noted that consumer price inflation had risen to 3.2 per cent in February, higher than expected and above the MPC's own target. Despite this, the Committee continued to hold the view that inflation would fall back below its 2 per cent target by the second half of the year.

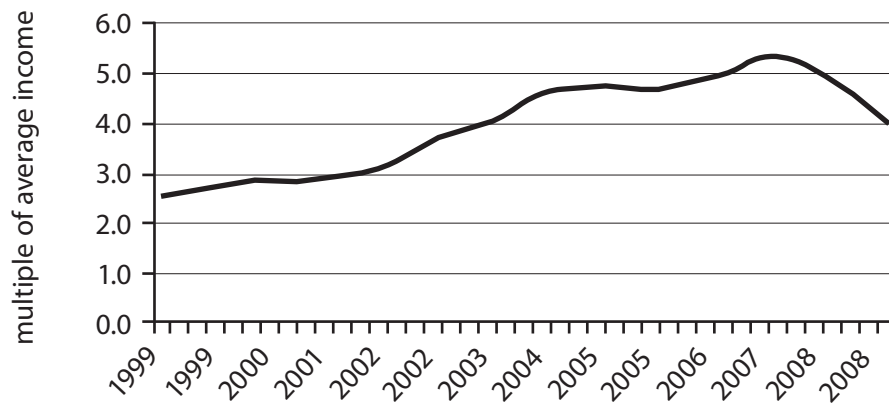
Source: adapted from *The Times* Online April 22, 2009.

**Figure 1: UK average house prices indicated by two large mortgage lenders, by quarter, 1999–2009**



Source: Halifax/Nationwide

**Figure 2: Average house prices (bought by first-time buyers) as a multiple of average income, by quarter**



Source: <http://www.nationwide.co.uk/hpi/historical.htm>

**\*21** Evaluate three ways in which economic policy can be used to 'stimulate UK economic growth' (*Extract 1, lines 4 to 5*).

**(30)**

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**(Total for Question 21 = 30 marks)**

## Question 22 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)

**22** Evaluate the use of supply side policies to achieve economic growth.

**(30)**

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**END OF SECTION B (Total for Question 22 = 30 marks)**

**SECTION C**

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

**23** In 2018, the United States Government cut the corporation tax rate (tax on company profits) from 35% to 21%. Income tax rates for US citizens were also reduced: for example, the top rate of income tax was cut from 39.6% to 37%.

(Source adapted from: <https://www.nytimes.com/>)

Evaluate the likely impact of cutting tax rates as a policy to increase economic growth. (25)

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**(Total for Question 23 = 25 marks)**

**24** In 2016 the UK Chancellor of the Exchequer announced that the government would spend an extra £23 billion on innovation and infrastructure over the following five years.

**(25)**

Evaluate the likely economic effects of this planned increase in government expenditure.

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

Handwriting practice area with 25 horizontal dotted lines.

**END OF SECTION C (Total for Question 24 = 25 marks)**