A-Level Edexcel Economics: Supply Side Policies Past Paper Questions

International House, 124 Cromwell Road, Kensington, SW7 4ET

0207 060 4494

www.expert-tuition.co.uk

EXPERT TUITION

Question 1

Which **one** of the following is most likely to cause an outward (rightward) shift in an economy's long run aggregate supply (LRAS) curve?

(1)

A Government policies to promote competition

B A fall in the quantity of imports of goods and services

C A rise in unemployment

D An increase in indirect taxation

Answer

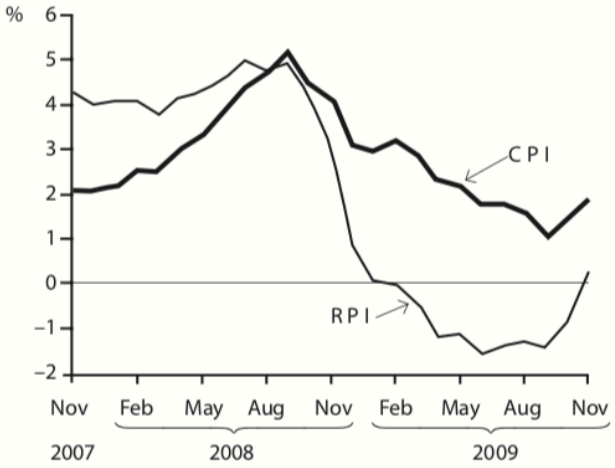
Explanation

(3)

Question 2

1 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 (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.

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.

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.

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.

(a) (i) With reference to Figure 1, explain what happened to the price level in the period shown. **(6)**

(ii) With reference to Figure 1, and your own knowledge, to what extent has monetary policy, as conducted by the Monetary Policy Committee, been a success? **(12)**

(b) With reference to Figure 2,

(i) Explain what is meant by a **fall** in *Gross Domestic Product at constant prices*. **(4)**

*(ii) Discuss **two** problems of comparing the economic growth of the UK and developing economies using GDP as a measure. **(12)**

(iii) Analyse **two** possible implications for macroeconomic policy of inaccurate forecasts of GDP growth data. **(8)**

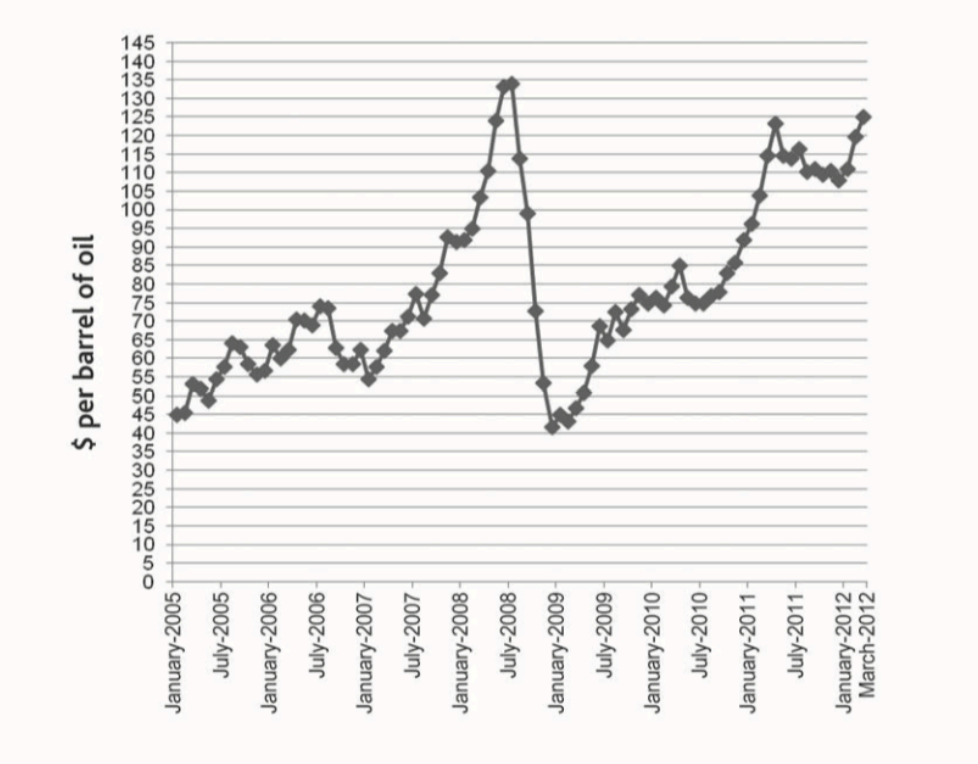
(c) With reference to Extract 1, analyse the possible impact on the distribution of income of negative economic growth. **(8)**

*(d) 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)**

Question 3 (aiii) and (c)

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.

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%.

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.

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.

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.

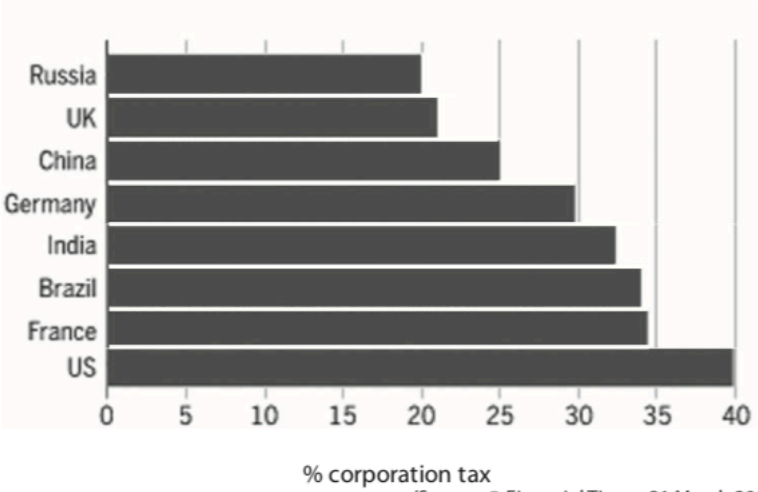
(Source: adapted from © Financial Times, April 3rd 2012)

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)

(a) (i) Referring to the data in Figure 1, calculate an index number for the oil price in March 2012, using January 2005 as the base period. Show your working.

(6)

(ii) With reference to Figure 1, explain **two** possible ways in which changes in the world economy could cause the movements in the oil price shown.

(8)

(iii) Using an aggregate demand and aggregate supply diagram, assess the effect on the UK economy of the rise in oil prices since 2009.

(12)

(b) (i) With reference to Extract 1, define a "deficit in the trade of goods and services on the current account of the balance of payments" (lines 2–3).

(4)

(ii) Explain **two** likely costs to the UK economy of a sustained deficit in the trade of goods and services on the current account of the balance of payments.

(8)

*(iii) With reference to Extract 1, assess the likely effect of a fall in the sterling exchange rate on the UK's deficit in the trade of goods and services.

(12)

*(c) Using the information provided and your own knowledge, assess the use of supply side policies, including a reduction in corporation tax, as a means of increasing UK economic growth.

(30)