

Edexcel (A) Economics A-level

AS-level Paper 2: The UK Economy

Example answers

June 2017

a) With reference to Figure 1, explain the term 'net trade'. (4)

Net trade is the value of exports minus the value of imports. It is the difference between the value of goods and services sold to other countries and the value of goods and services bought from other countries. From figure 1, the UK's net trade is -2% of its AD. This means that the imports are larger than exports and represents a decrease in the AD. Germany has the highest net trade in proportion to AD, at 6% of its AD.

Teacher's comments: 4/4

b) With reference to the information provided and your own knowledge, assess the likely causes of the UK's trade deficit. (10)

The UK has a trade deficit of -2% of AD. Firstly, one reason for this is low output in construction and manufacturing industries. Manufacturing output is 6.3% below its peak before the recession. This decreases net trade since it means that the UK has less manufacturing goods to export, and therefore they can export less. Manufacturing and construction used to make up a huge part of the UK's exports e.g. the shipbuilding industry, but recently this has become less important. This decrease may have led to the UK's trade deficit. This factor is likely to be less significant since there are many other industries which could increase exports and reduce the deficit. There has been high output in general, the highest rate in the G7, and so this cannot be that significant.

Another reason could be the high growth within the UK. GDP has risen by 40% since 2000. This means consumers will have a higher income and will have more demands that cannot be met within the UK. This will lead to an increase in imports, and therefore increase the trade deficit. The increase in indebtedness means that there has been an increase in consumption and so this could be a reason.

The most important reason is the UK's low productivity. It is 20% below the average for the rest of the G7. This will mean that costs are higher since production is not efficient and so more resources/time are needed to produce the same amount of goods as other countries. Higher costs lead to higher prices, and this makes UK goods less competitive. Not only will this decrease exports, it will increase imports as UK consumers will want to buy the cheaper goods from other countries. The price will depend on the exchange rate, and since the pound is stronger than other currencies e.g. the euro, imports will be even cheaper and exports even dearer. This is the most important reason since it impacts all industries, particularly the service industries, and both exports and imports.

Teacher's comments: 8/10

c) With reference to Extract A, paragraph 2, explain one likely influence on UK investment. (5)

Investment is business spending on capital goods. One factor it depends on is interest rates. The fall in interest rates to 0.5% will have helped investment to grow by 5%. Firstly, the fall in interest rates makes borrowing cheaper and this will encourage borrowing since the rate of return on investment needs to be lower to be able to pay back the loan. High interest rates means that firms

need to get a high return on their investment to make it worthwhile. Moreover, low interest rates reduce the incentive to save retained profit since there will be less interest received on saving. As a result, firms may be encouraged to invest their retained profit instead. Together, these reduce the opportunity cost of investing and so will make firms more likely to invest.

Teacher's comments: 5/5

d) With reference to Figure 2 and Extract A, explain two likely reasons why the growth of the UK's nominal GDP per capita at PPPs was slower than that of Germany after 2010. (6)

The UK's nominal GDP per capita at PPP grew from 132 to 140 index (by 8 index points) whilst Germany's grew by 12 index points. Firstly, this may be because of Germany's trade surplus. This means there is an injection of 6% of GDP into the economy, which will have a multiplied effect in the economy and increase output even further than this 6% due to the circular flow of income. On the other hand, England has a trade deficit and so there is a leakage of 2% from the economy every year. This means there will be a multiplied effect of the leakage and GDP will fall even further than the initial fall. On top of this, Germany could have grown more because the UK is unproductive. As a result, output is lower than it could be and less goods and services can be produced with the level of resources.

Teacher's comments: 3/6

Changes in population? Productivity? Currency? Remember to define key terms in the question- PPP and GDP per capita

e) Evaluate policies the government could use to increase the UK's productivity. (15)

The government can use supply side policies to improve productivity. Firstly, they could improve the skills of the workforce. They could spend more money on education so young people have more skills and so could become more efficient and productive, since they are better at their job. One area which it is important to improve is vocational training as this will provide the workforce with the skills they need to become more productive at work. They could encourage people to take up the T-Level (technical equivalent to A Level) and improve the apprenticeship system to train people in particular areas: "construction, manufacturing and technology". This will help the next generation of the work force to have the skills necessary to work in the economy and ensure they are productive. The effect of this will depend on the uptake of these systems since government improvements will make no difference if people do not use the systems. One problem with this is the time lags, since it will take time to improve apprenticeships and ensure post 16 options other than A Levels are seen as providing equal value and for people to go through the system. On top of this, they can enforce regulation to ensure firms provide on-the-job training for their staff. This will be better in the short term as it will mean the current workforce are retrained to have the skills they need in the current economy and that these skills are maintained. The continuous changes in technology etc. means this is beneficial as it ensures workers will always be up to date with the newest methods and so can continue to be productive. However, it can act as a disincentive to firms to increase employment as it will increase their costs. In the long run, costs will be decreased by more productive staff who are better at their job.

On top of this, they could remove strict regulation. A detailed planning system makes firms inefficient as it takes them a long time to get through the planning system and costs a lot of money. As a result, they cannot be productive. Similarly, carbon taxes increase costs and makes firms unproductive. Therefore, the government can remove these to increase productivity as it will mean firms can focus on their tasks and so will be more productive. However, these are put in place to improve the environment and ensure things are done safely. Hence, if they are removed it could decrease quality of life.

Overall, the best way to improve productivity would be a combination of on job training, which will ensure workers are up to date with the newest technology, and education training which would improve vocational skills e.g. apprenticeships.

Teacher's comments: 12/15

f) Evaluate the benefits of economic growth to the UK given that 'a number of concerns remain' in the UK economy (Extract A, line 7)

Economic growth has many benefits but the issues in the UK economy reduce this. Firstly, economic growth will increase the quality of life within the UK. There will be more jobs available and higher wages, reducing poverty within the UK. This is likely to improve life expectancy since people can afford good healthcare (the NHS will be better funded) and have a good diet. However, the UK is already highly developed and there is likely to be little changes to quality of life and small increases in GDP will have little impact on most people in the UK.

Moreover, economic growth could be good since it will lead to increased business profits, since AD is higher and therefore there is high consumption. This may increase investment in the UK and therefore improve research and technology. If new technologies are discovered, this may be able to improve the productivity within the UK. More up to date machinery could be bought which will mean production can be faster and therefore the UK will be more efficient. High growth is a good time for the government to increase spending in education (since taxes are higher and welfare payments are lower) and therefore improve UK productivity through higher skilled staff. Instead of the concerns hindering growth, the UK can use this period of growth in order to fix one of its biggest problems, productivity. This will improve growth in the long run.

One problem with the consumer-led growth is that it may lead to increase imports since consumers have more income and therefore higher demand which cannot be satisfied within the UK. This will increase the deficit even further and will make growth unsustainable as there is increased leakages from the economy which will have a multiplied effect due to the circular flow.

Even if growth is not sustained, it will be beneficial if it improves the government budget. As tax revenues will be higher and welfare payments lower, the government may be able to afford a budget surplus. As a result, they could begin to pay off the national debt.

The concerns in the economy, low productivity, balance of payments problems and high consumer debt, means that growth is unlikely to be sustained. This means that any benefits of growth are likely to be short term. If the UK cannot use the growth in order to fix its problems, then these benefits will be insignificant. Growth could be used to improve productivity through research and investment. The improved productivity will help the balance of payments problems since it will

reduce costs as less resources are needed and therefore reduce prices, which will increase exports and decrease imports as the UK's goods are more competitive.

Teacher's comments: 14/20

Good points. The last paragraph is key and you could spend a little longer there. Could show diagram.