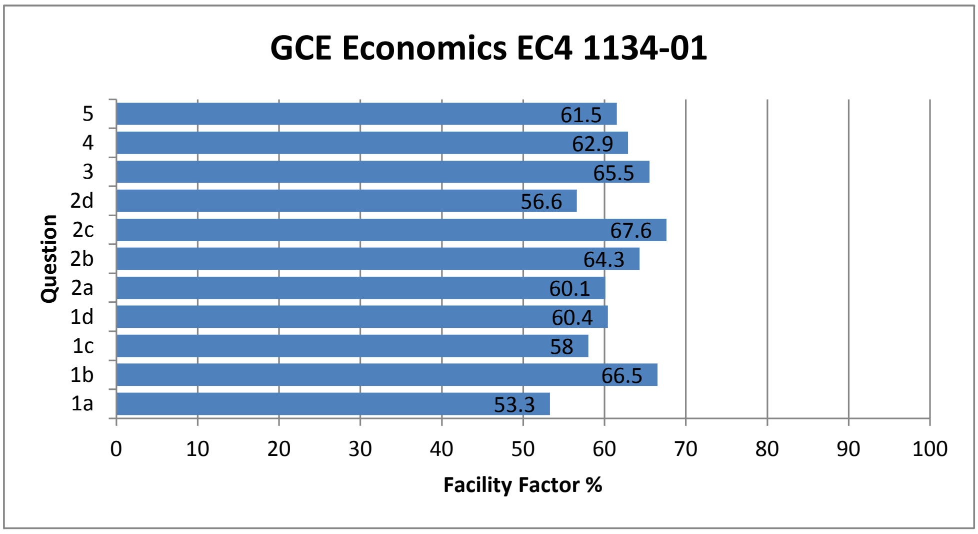
WJEC 2014 Online Exam Review

GCE Economics EC4 1134-01

All Candidates' performance across questions

Question Title	N	Mean	S D	Max Mark	F F	Attempt %	
1a	270	4.3	1.5	8	53.3	69.8	
1b	270	5.3	1.3	8	66.5	69.8	
1c	270	7	2.1	12	58	69.8	
1d	269	7.3	2.1	12	60.4	69.5	
2a	117	4.8	1.2	8	60.1	30.2	1
2b	117	5.1	1.5	8	64.3	30.2	
2c	117	8.1	1.4	12	67.6	30.2	
2d	117	6.8	1.9	12	56.6	30.2	
3	172	13.1	2.8	20	65.5	44.4	3
4	157	12.6	2.6	20	62.9	40.6	
5	58	12.3	2.9	20	61.5	15	



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

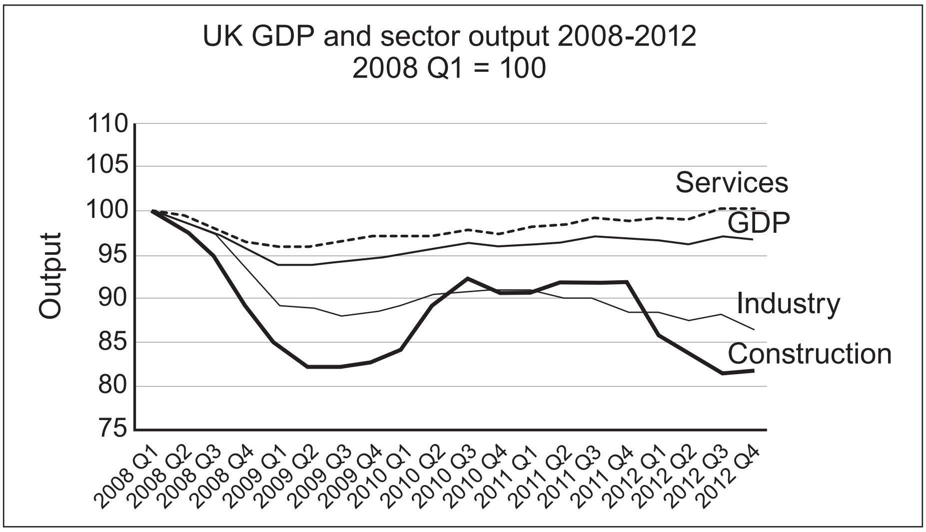


Figure 2 – UK house prices

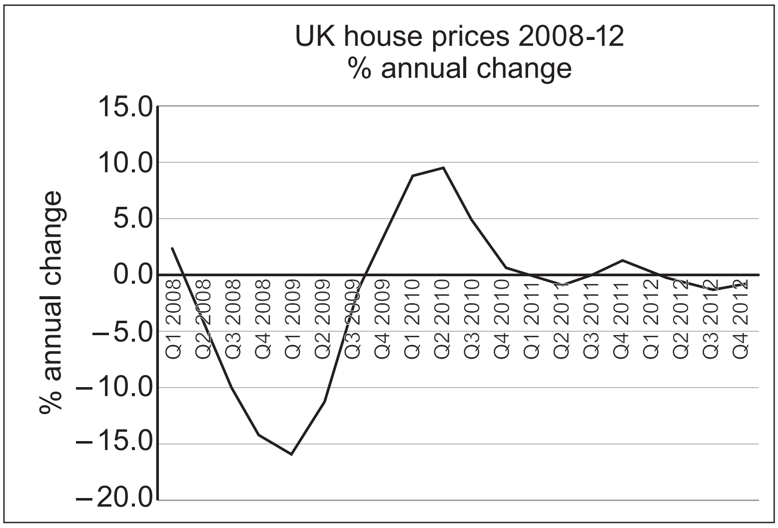


Figure 3 – UK mortgage rates

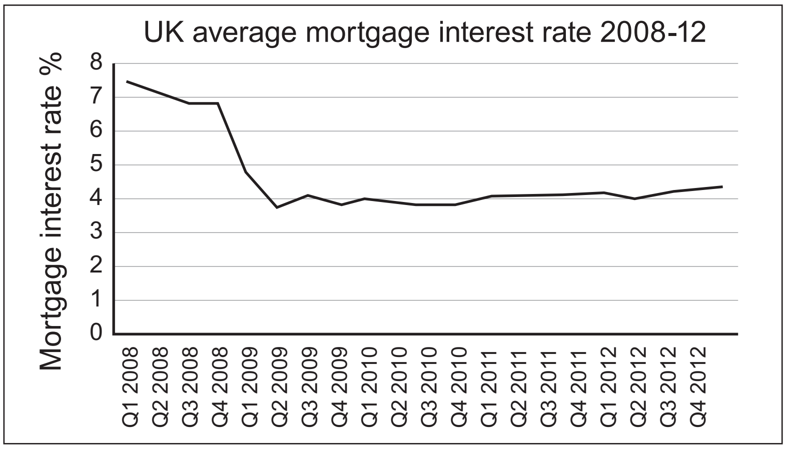
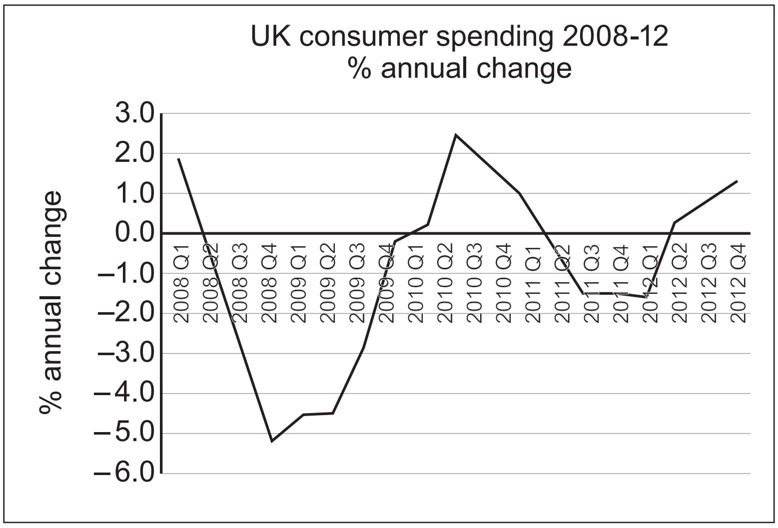


Figure 4 – UK consumer spending



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.

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".

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."

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.

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.

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."

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.

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."

A climbdown 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.

(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]

Question number | Leave Blank

2a. Figure 1 shows us how different sectors of the economy have faired during the ~~rece~~ recession.

The data shows that over the period GDP has decreased by about 4% relative to Q1 2008 levels. The data also shows that services, despite a 4% dip by 2009 have recovered to pre crisis levels. This is indicitive of the strength of Britains financial markets. The service industries have proved to ~~be~~ be relatively income inelastic, this means demand hasn't fallen significantly with the falling real incomes.

Construction has fallen most significantly. By 2009 it had fell by 17%. However demand did pick up owing to the resurgent housing market between 2009 and ~~200~~ 2010. The market increased to 93% of pre crisis levels. However in late 2011 the market again started declining to 82% of its peak in 2008. This is partly due to the slowdown in ~~to~~ the housing market seen in Fig 2.

We can see industry has followed a significant fall in output like construction. It ended 2012 at 13% lower than its 2008 output. The main reason the fall will be the decrease in investment meaning firms are purchasing less capital goods ~~in~~ ~~industries~~ like JCB ~~[illegible]~~ equipment. The market for industry has also suffered from its high income elasticity of demand for goods like Jet Engines from Rolls-Royce.

We have seen that production of goods has fallen faster than ~~that~~ of ~~industries~~ services.

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2b. Changes in output can occur for multiple different reasons these can include ~~and~~ international competition, the state of the macro economy and the level of demand for the good.

The construction sector has seen a significant decline. One possible reason for this is the lack of demand for new houses during the period. Fig 2 shows us that ~~despite a~~ apart from a small period of property market rises ~~the~~ house prices have been relatively ~~steady~~ flat. This indicates demand was falling for homes. This is probably because of the lack of confidence in housing and the wider economy. This lack of demand means construction firms will ~~all~~ build less houses thus lowering output. There has also been a lack of infrastructure spending which will have reduced demand and ~~thus output~~ therefore reduced output.

Industry has also seen a decline, the main cause of which is probably lack of ~~co~~ confidence in the economy for both ~~co~~ consumers and businesses. This means they will not ~~be~~ buy the goods Britain makes. Britain is known for producing luxury goods like jet engines and performance cars. ~~Britain~~ Demand for these ~~is highly income elastic~~ is ~~is~~ highly dependant on businesses perceiving a return on investment and on consumers being confident about their income. The high income elasticity of demand ~~of~~ for British industrial output also means output will fall during a recession as real incomes fall.

The services sector however has remained relatively steady over the period. The reason for this will be rising demand from countries like India and China for British financial services, this will have helped compensate for the fall in domestic demand.

The change in GDP has largely been caused by the sharp decline in Construction and Industry but also by a lack of consumer spending, fig 4 shows consumer spending fell significantly over the period.

2c Interest rates are the cost of borrowing and the reward for saving. Low interest rates mean borrowing is cheap and saving is unattractive.

The bank of england is keeping interest rates low in an attempt to sustain the ~~weak~~ weak economic growth. This is because cheap borrowing encourages investment and consumption. This increases AD, ~~AD~~ aggregate demand = Consumption + Investment + Govt spending + exports - imports.

This means AD will be higher than if interest rates rose.

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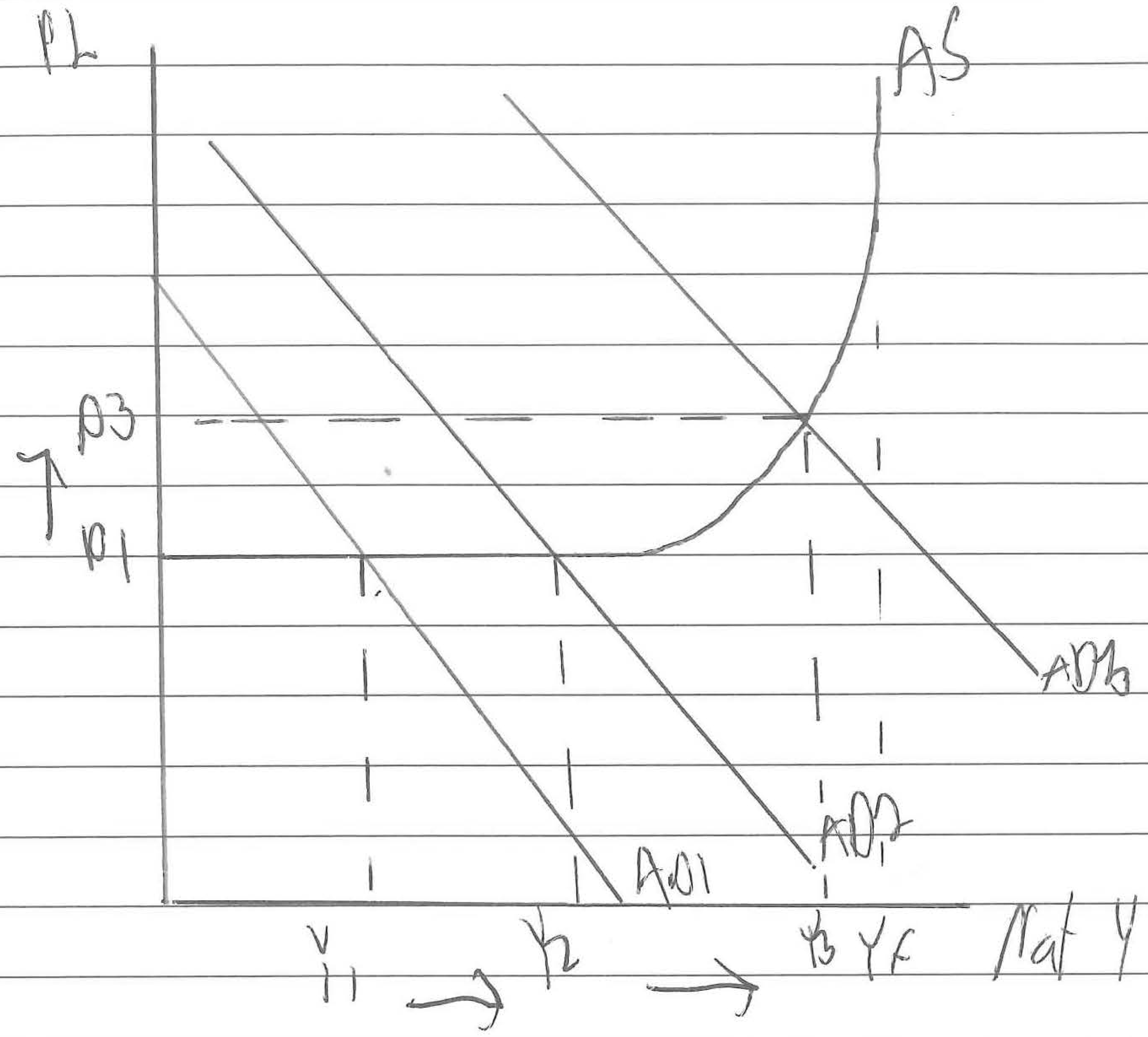

The relative rise in AD will shift AD1 to AD2. This will increase National income to Y2. This will have a positive effect on growth and employment. However if AD rises into the upward sloping section of the demand curve such as AD3. The rising national income will be tempered by inflationary pressure as the price level increases to P3.

Some argue the lack of investment is not due to the cost of borrowing but the availability. In this case the announcement will not have a significant effect.

The announcement itself may be damaging. People may begin expecting inflation to rise. This will lead to higher wage demands to protect themselves which in turn leads to the higher costs and therefore prices they are afraid off. This is a movement up the

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	On the other hand businesses may see the arrangement as a ~~good~~ enabler to investment. This is because there is less uncertainty about the cost of repayment. This also applies to consumption which may increase as there is more certainty over loan repayment costs.	
	We have seen the Bank of England's decision to keep interest rates at 0.5% has not resulted in inflation as was feared when inflation reached 5.5% but instead inflation has fallen to 1.6% whilst growth and employment have improved indicating their decision. Although some, including Shadow Chancellor ~~FO~~ Ed Balls argue the measures of austerity slowed down growth and the recovery. ~~They~~ some also argue that although inflation may be low inflationary pressure is rising rapidly, this is the view of IMF chair person Christine Lagarde.	
2d.	A deficit is where outgoings are greater than income. The government's public sector deficit means it's spending more than it recieves.	
	One reason Osborne wants to cut the deficit is to avoid future generations being burdened with the debt. Debt repayments mean the government can spend less on capital investment. This will have a detrimental effect on the economy particularly growth. Osborne is also worried about the long term tax and spending implications. ~~A~~ A greater debt may mean taxes have to ~~rise~~ further or spending has to fall	

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Osborne also sees cutting the deficit as ~~fundamental~~ fundamental to the countries economic ~~sta~~ stability.

However many argue his austerity measures are harming growth, the higher taxation creates a disincentive to enterprise. This means people will either not set up businesses in the UK or just not set them up. This will lead to a reduction in the increase in capacity Britain can hope for.

Others argue the negative effects are more immediate and may include falling employment in the public sector and lower disposable income. This will lead to falls in AD as consumption will fall, this will in turn lead to a fall in ~~emp~~ employment as demand for labour is derived from AD. AD will also fall with the decrease in government spending.

In the long run Britain may see a rise in international competitiveness. This is because inefficient workers will be sacked and businesses become rationalised. This will improve productivity and enable firms to lower costs and therefore become more competitive in the global market. This will have long run positive implications not only for balance of payments but also growth.

On the other hand one could argue competitiveness will fall. Excessive fiscal control can lead to a shortage of investment by the government in capital goods. This means productivity

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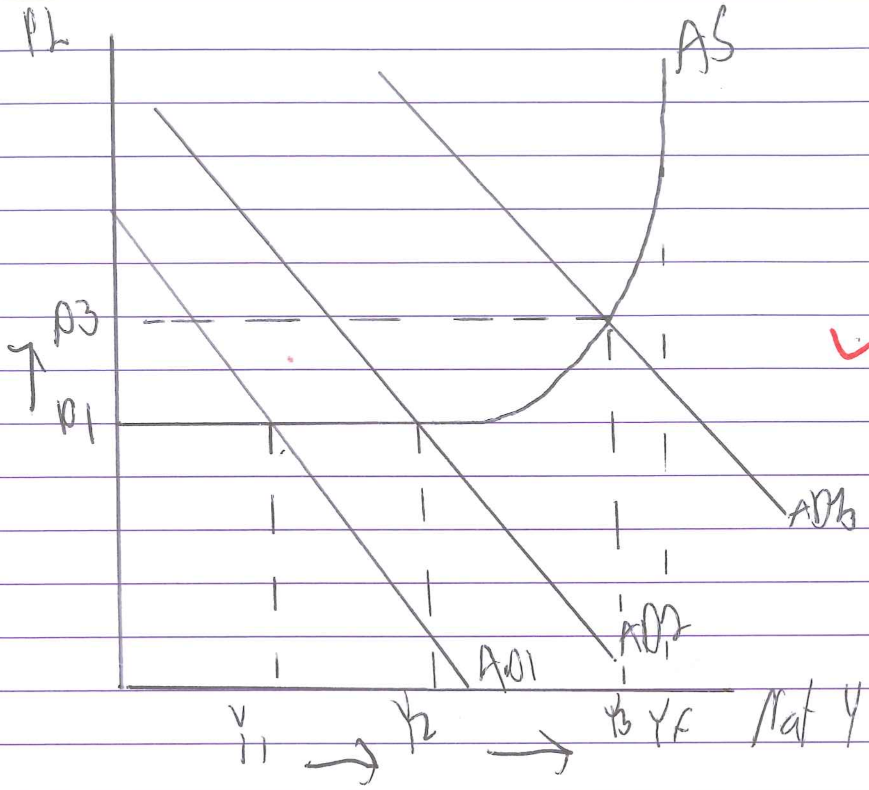

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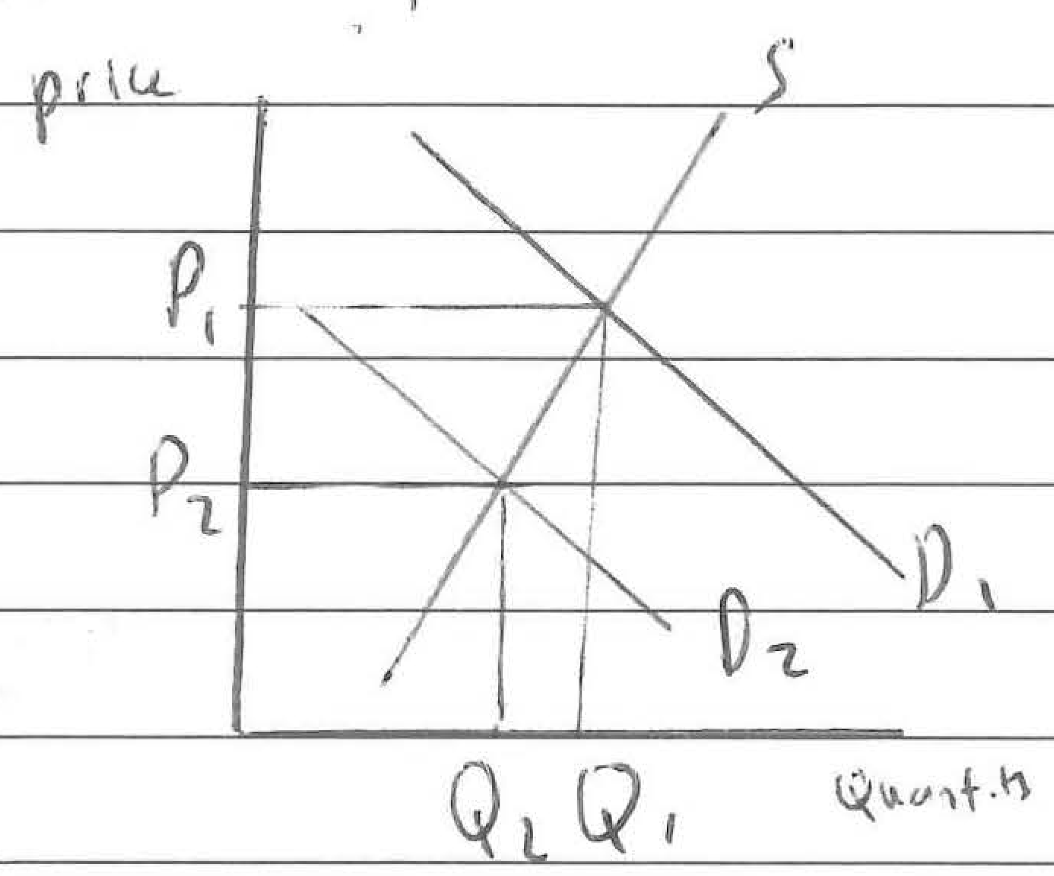
2. b) In Figure 1 there is a significant reduction in construction from 2008 - 2012. In 2008 house prices fell by 15%, this is likely to be due to a decrease in demand for houses to for instance D_2 from D_1 showing the fall in price from P_1 to P_2. This results also in a decrease for quantity demand which may of caused the fall in output by over 15%. in 2008. As builders aren't going to start construction when there is no demand for housing. When prices of housing started to rise again at the end of 2009 which would be due to a decrease in mortgage interest rates to 4% from 7% in 2008, (as it's cheaper to mortgage a house), construction as expected began to rise. As house prices fell again so did construction levels. Overall the services sector fell slightly in 2009, which would be expected in a recession but stayed relatively high likely due to exporting and previous investment. Industry as a whole has fell this would be due to a weakness of consumer demand in Britain, with even big names such as HMV closing down it's almost obvious consumers lost confidence in the UK economy which drove down spending in industry.



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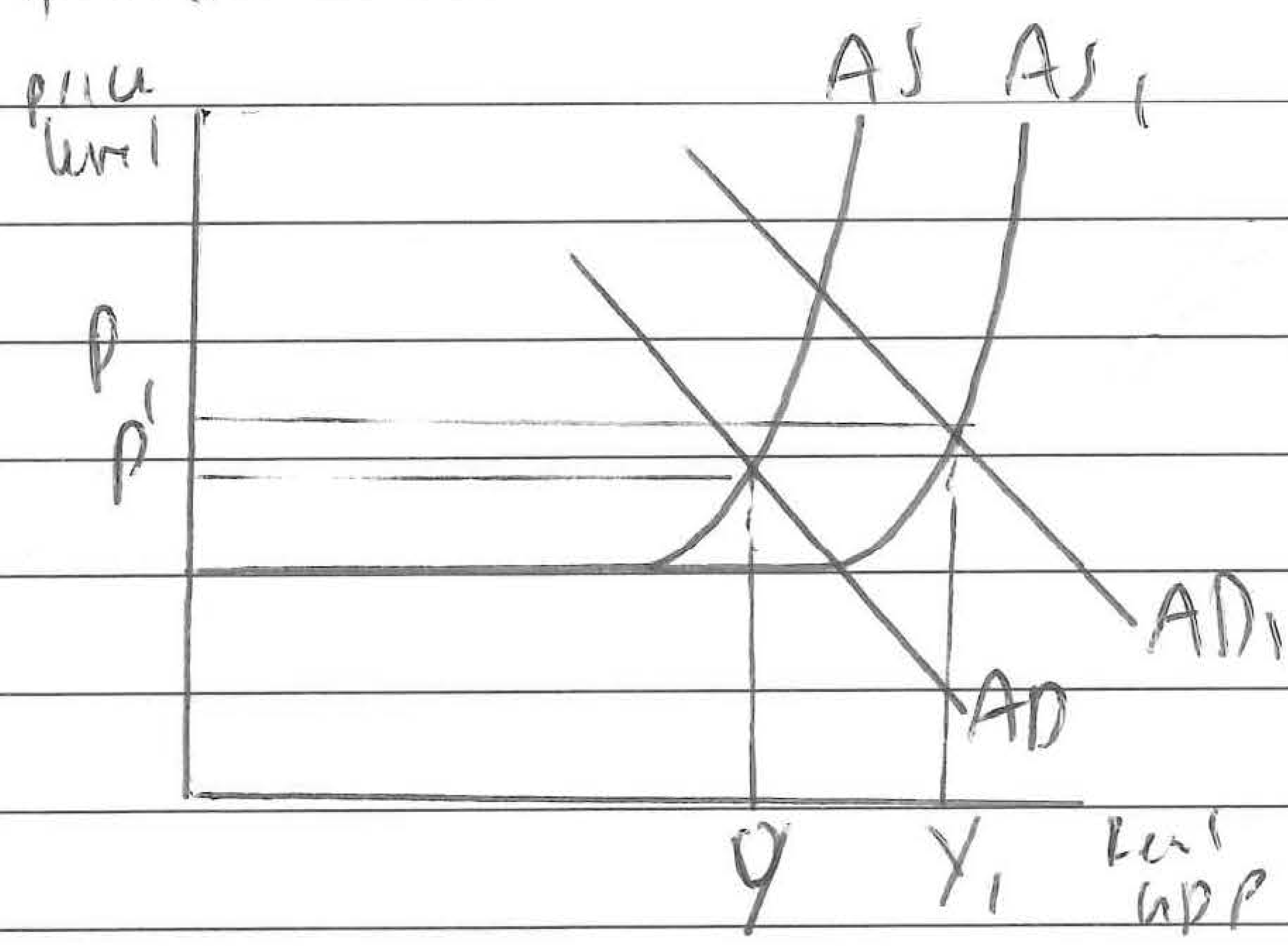
2. i) The Bank of England has kept interest rates low at 0.5% currently too boost economic growth by increasing investment and consumer spending.

Lower interest rates set by the Bank of England are therefore passed on to the market at a lower interest rate too. This in turn should attract businesses to invest in the UK through FDI or increase investment in previous firms.

This will caused a shift in AS to AS_1, as firms will be able to employ and produce more. Also lower interest rates would be expected to boost consumer spending as it's less attractive to save the money with less returns. This will boost AD to AD_1. Overall this should create economic growth of $Y_1 - Y$. This would help us get out of recession and kick start growth. Whilst still backing the Chancellor's objective of reducing the deficit as no mass of government spending is involved, continuing austerity.



However this has not been the case, with low interest rates there has still been lack of consumer demand in Britain. Even with low interest rates, there has been weak growth suggesting lack of confidence. Instead it may be better to spend on improving the country's infrastructure

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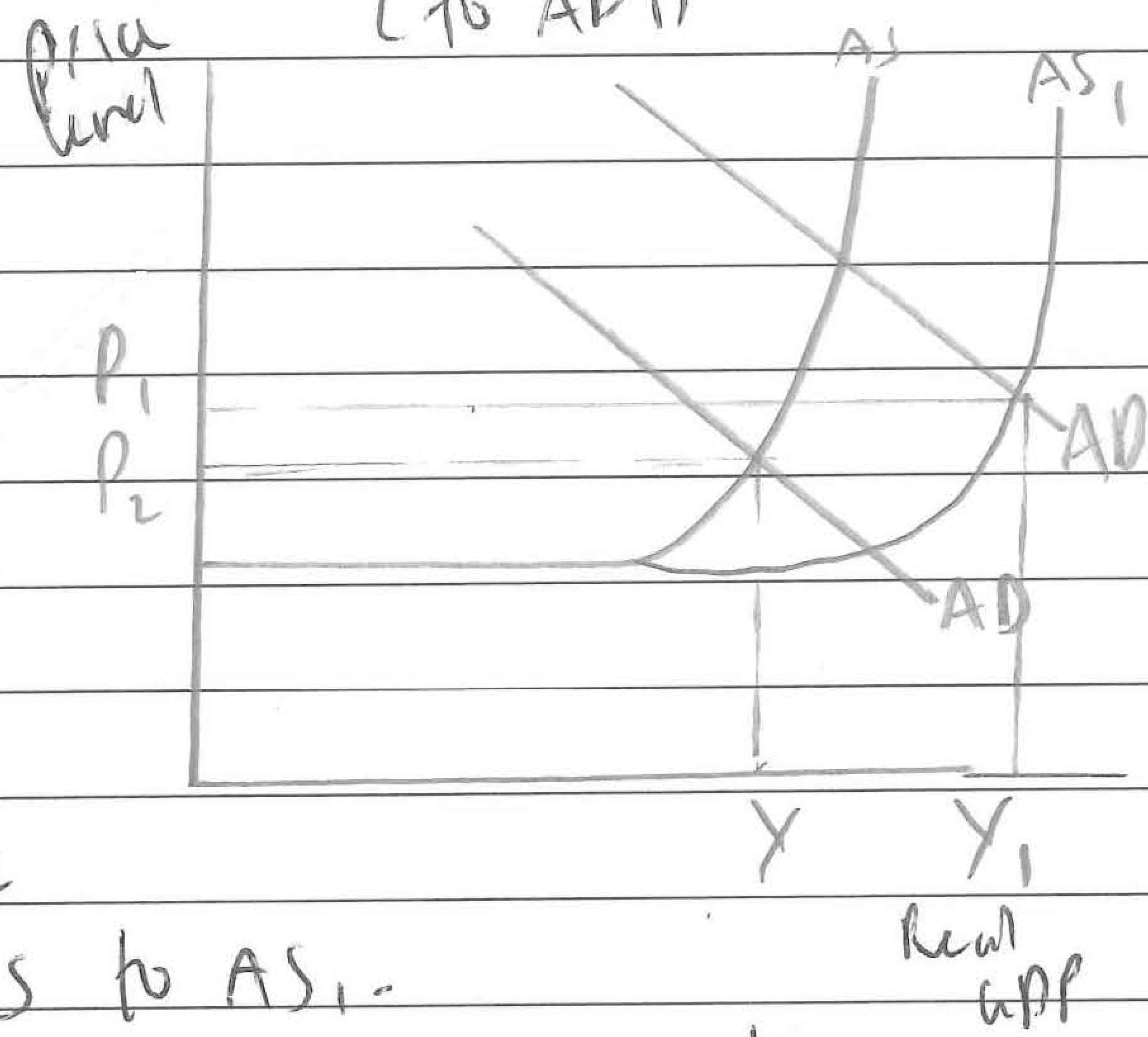
which will have the effect of boosting AD and AS, leading to economic growth. This in turn should create confidence. It has also been suggested that credit should become more available to cash-starved business allowing them to innovate and invest creating growth.

On the other hand, keeping low interest rates ~~for~~ up until mid 2015 would eventually have an effect of boosting consumption and investment. It also allows our exchange rate to be kept low and make our exports more internationally price competitive enabling growth and employment. There is concerns that ~~[illegible]~~ continuing low interest rates will increase inflation. But ~~[illegible]~~ ~~[illegible]~~ currency said inflation should be less of a concern, as growth in times of recovery is more important. It could ~~[illegible]~~ be said ~~[illegible]~~ that this use of monetary policy ~~has~~ will have little effect and ~~[illegible]~~ more public spending is the best way to improve the economy.

2. d) The recession was caused by a collapse in the banking system, but most importantly consistently high government spending without the same amount of income coming in from taxes. ~~[illegible]~~ This has lead to decisions to reduce the deficit to recover from the recession ~~[illegible]~~ sustainably.

However it could be argued that if Osbourne infact stopped cutting the public sector deficit we might improve and recover even better. If government spending were to increase in the short run there would be a boom in the economy through AD ($C + I + G + X - M$). (to AD_1)

This would increase consumer spending for example if they spent it on education, as jobs will be created. Education also allows for improvements in our productivity as a nation, making factors of production more employable leading to a shift in AS to AS_1.



The economy would therefore of grown by $Y_1 - Y$ with a price rise of $P_1 - P_2$. This may go against Osbourne's policy but it would likely in the long term benefit the economy through increased employment. Also it may not effect the deficit in the long run as it would get the money back through higher income tax on the employed and less unemployment benefits.

On the other hand, the reason Obsobourne has had such a grip on the nation's purse is because with austerity in the long term we are likely to benefit. By reducing the deficit we will improve our reputation as an economy and create stability. This may have in the long term effects of increasing investment and improving the economy with less of a burden on the debt. Having an on going deficit can be viewed as unsustainable and eventually cuts and high taxes would have to be made.

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Also by reducing government spending it reduces crowding out and allows more ~~the~~ private firms to enter the market. private firms are likely to be more efficient and produce long term benefits of growth, employment and possible decreases in prices. It is likely that growth in the economy will eventually increase but there is a long time lag for these benefits to take place.

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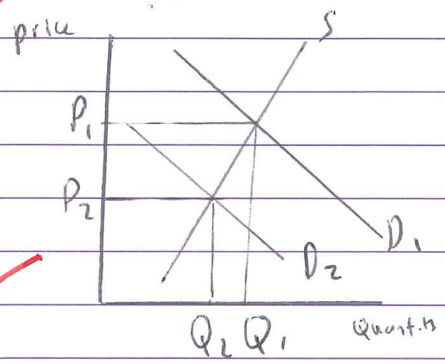

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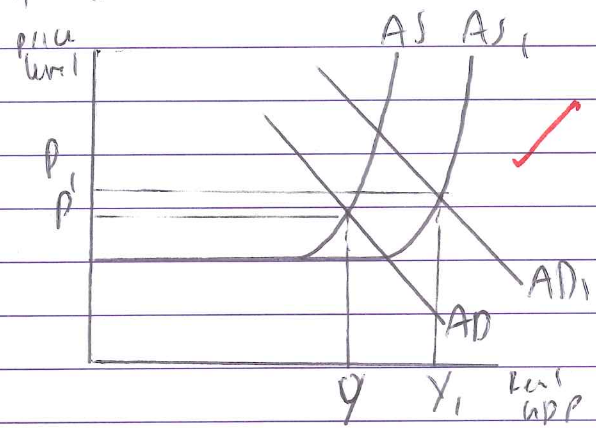

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which will have the effect of boosting AD and AS, leading to economic growth. This in turn should create confidence. It has also been suggested that credit should become more available to cash-starved businesses allowing them to innovate and invest. creating growth.

On the other hand, keeping low interest rates ~~for~~ up until mid 2015 would eventually have an effect of boosting consumption and investment. It also allows our exchange rate to be kept low and make our exports more internationally price competitive enabling growth and employment. There is concerns that ~~boo~~ continuing low interest rates will increase inflation. But ~~[illegible]~~ ~~that~~ Carney said inflation should be less of a concern, as growth in times of recovery is more important. It could ~~[illegible]~~ be said ~~[illegible]~~ that this use of monetary policy ~~has~~ will have little effect and more public spending is the best way to improve the economy. 9

2 d) The recession was caused by a collapse in the banking system, but most importantly consistently high government spending without the same amount of income coming in from taxes. ~~Now~~ This has lead to decisions to reduce the deficit to recover from the recession ~~[illegible]~~ sustainably.

However it could be argued that if Osbourne infact stopped cutting the public sector deficit we might improve and recover even better. If government spending were to

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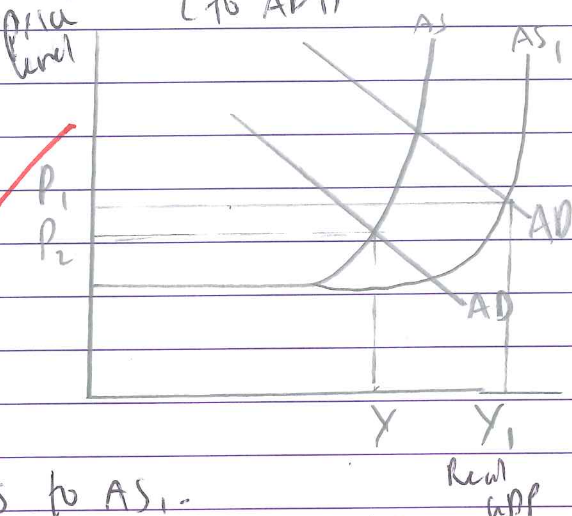
increase in the short run there would be a boost in the economy through AD $(C + I + G + (X - M))$ (to AD_1)
This would increase consumer spending for example if they spent it on education, as jobs will be created. Education also allows for improvements in our productivity as a nation, making factors of production more employable leading to a shift in AS to AS_1.



The economy would therefore of grown by Y - X with a price rise of $P_1 - P_2$. This may go against Osbourne's policy but it would likely in the long term benefit the economy through increased employment. Also it may not effect the deficit in the long run as it would get the money back through higher income tax on the employed and less unemployment benefits.

On the other hand, the reason Osbourne has had such a grip on the 'nation's purse' is because with austerity in the long term we are likely to benefit. By reducing the deficit we will improve our reputation as an economy and create stability. This may have in the long term effects of increasing investment and improving the economy with less of a burden on the debt. Having an on going deficit can be viewed as unsustainable and eventually cuts and high taxes would have to be made.

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Also by reducing government spending it reduces crowding out and allows more ~~the~~ private firms to enter the market. private firms are likely to be more efficient and produce long term benefits of growth, employment and possible decreases in prices. It is likely that growth in the economy will eventually increase but there is a long time lag for these benefits to take place.

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2 a) Between 2008 and 2012 the output of different sectors of the economy varied greatly. In Q1 ~~off~~ 2008, Services, GDP, Industry and construction all started at 100.
Services varied slightly as time went by, lowering to around 97, but then grew back to the 100 mark by 2012 Q3. So they only lowered slightly in the 2008 – 2012 period.
GDP lowered slightly quicker to a low of 94 in Q1 of 2009, before slightly rising and remaining fairly steady at around 96 – 97 from 2010 Q3 ~~until~~ till 2012 Q4.
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For all 3 sectors of output and GDP, they all fell below the 100 mark for the 2008 – 2012 period, with only Services rising back to the original amount.
All four measures dropped until 2009 Q1 with only construction really falling after that point immediatly. So there ~~was~~ was a negative relationship with time and output for all ~~four~~ four for this period.

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(6) The time measurement was straight after what Mervyn King described as the Non-inflationary continuous expansion period of 1993-2008, where there was low inflation, sustainable growth, and falling unemployment. So it could be argued that it was only a matter of time until output started falling and the economy started to fail. Because of the sub-prime mortgages in America, it lead to the global recession. The recession happened because American bank started to lend to NINJA's (No income, no job or assets). The recession spread to Britain which could have effected the British economy. And it did effect it as shown. Global demand went down, which meant less demand for British exports which could explain falls in output across the three sectors. Especially in Industry and construction because foreign consumers would switch to cheaper options possibly supplied from LEDC's. But the service sector, one which UK specialise in, would not have been as badly effected because there aren't as many competitive alternatives, as shown in the diagram where there was only a slight drop. GDP is effected by AD and AS, and this fall in GDP suggests that either there was a contraction in the economy because of a

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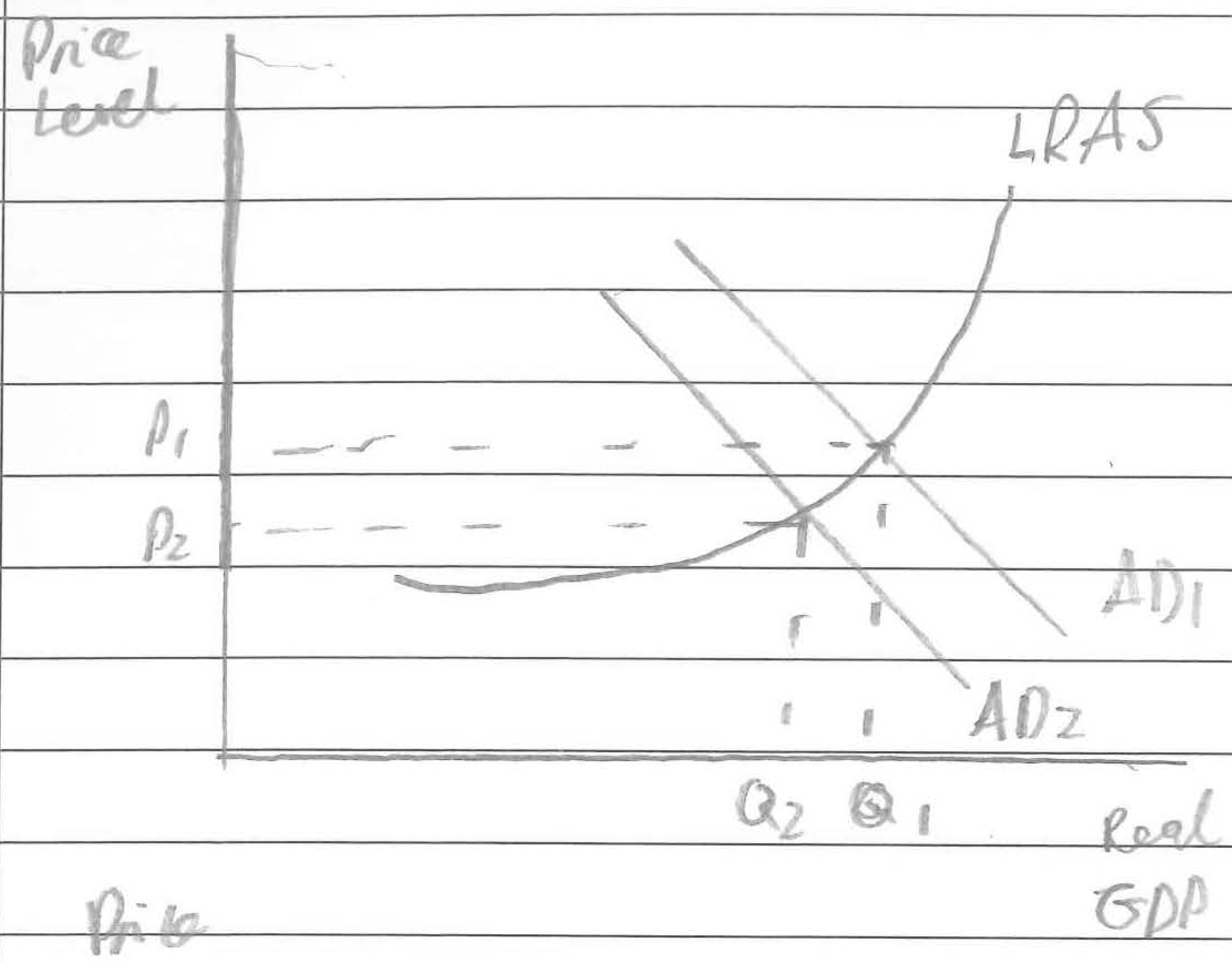
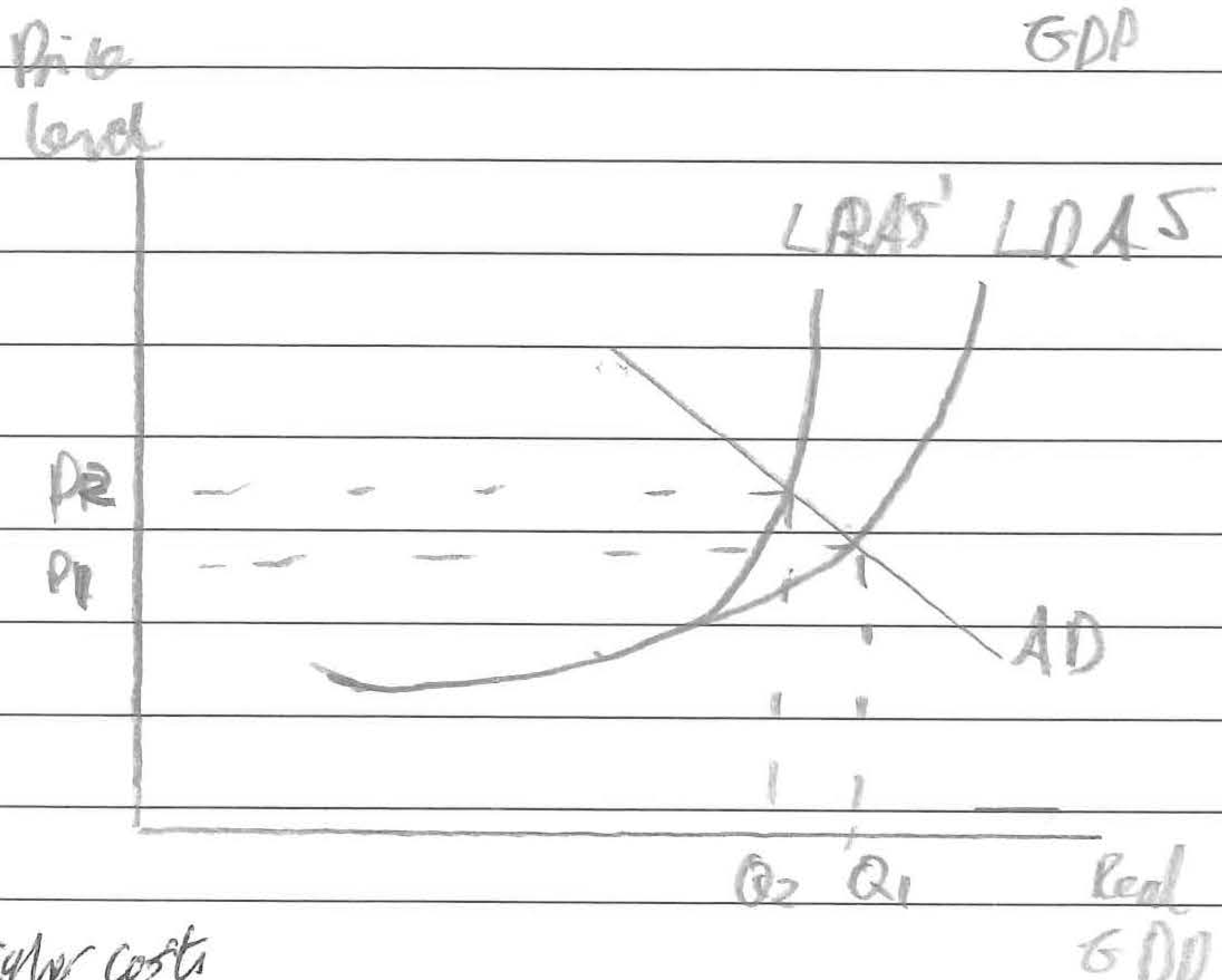
reduction in AD, or a higher average costs for businesses, reducing LRAS.



This could result in Malign deflation, which is very bad for an economy.



Higher costs

~~Both~~ will lead to higher inflation and a reduction in AS, because of cost push inflation.
House prices also plummeted during this period, as shown in Figure ~~1~~ 2, to a low of −15% annual change in 2009 Q1.
This would be because of reduced demand for houses and excess supply. Reduced demand means that less houses need to be built, which is why construction fell at such a fast rate.

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It will also devalue the currency as there will be less demand for the pound because saving in British banks ~~wont~~ isn't as attractive. So AD should increase further because of more exports, which are now cheaper, and less imports which become more expensive. This depends on the Marshall-Lerner condition that elasticities of Demand for imports and exports are more than 1, because if they're not, then a devaluation could result in less AD because of the J curve effect.

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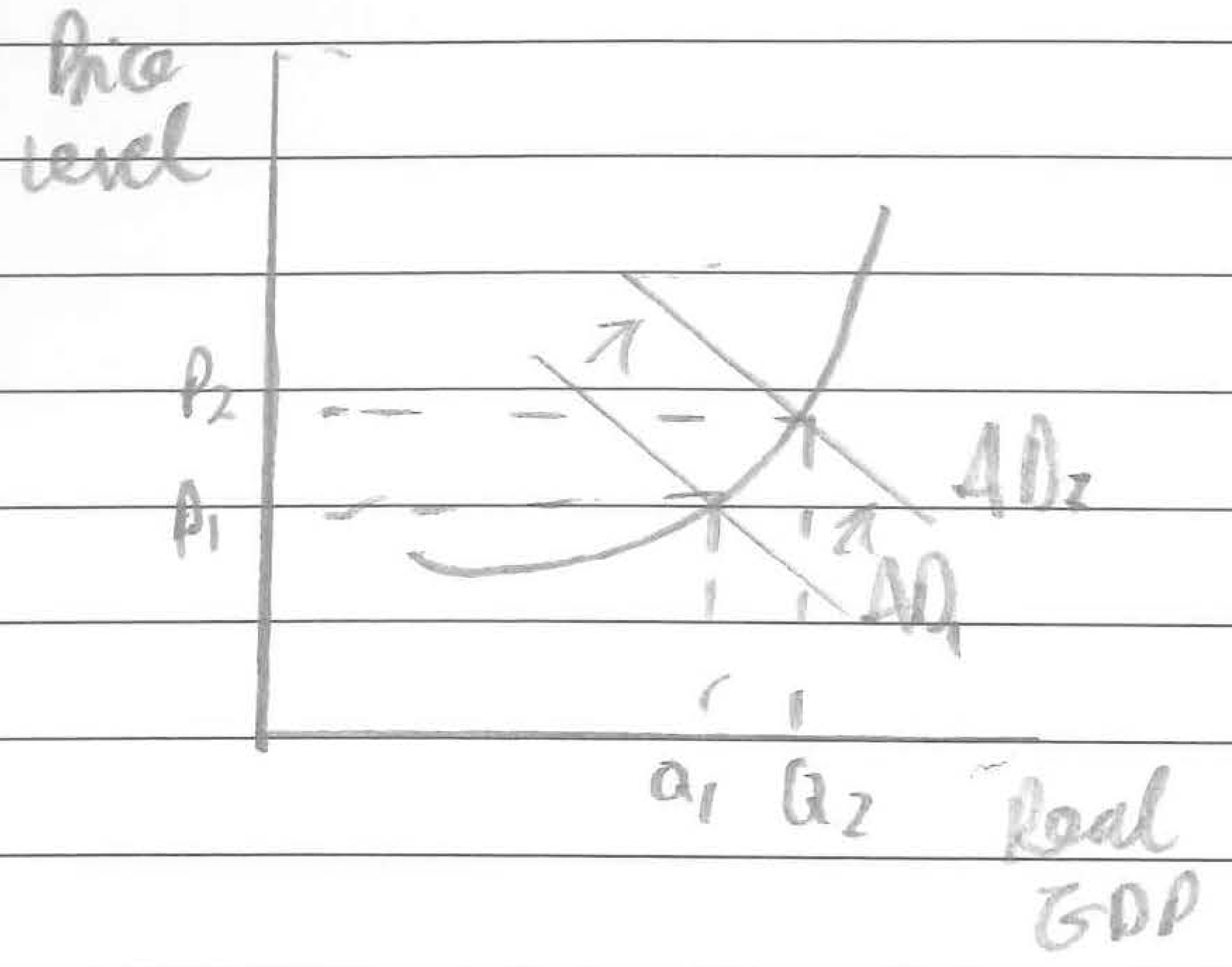

If Marshal-Lerner Condition is present, then there will be more export revenue to and lower costs of imports. This will cause AD to rise because of higher X and less M, along with higher C and I because borrowing is now cheaper and savings are more costly. The shoe-leather effect of less savings in banks. This should lead to higher growth and inflation, with less unemployment.

However, this depends on Harrod-Domar Growth model, which means growth is dependent on the levels of national savings and the productivity of capital investment. Transparency can help consumer confidence.

There could also be negative effects on an economy because of lower interest rates, because of the paradox of thrift, if the global willingness to save is greater than the global willingness to invest, then low interest rates won't necessarily increase AD. Keynes used the term animal spirits relating our behaviour dependent on our instincts, and if there is poor animal instincts and low confidence, then AD won't necessarily increase. If there's higher FDI, then that means that foreign companies will have a larger say on what goes on in an economy, and if interests rates were ~~highered~~ increased, they could just go to a different country with low IRs to borrow and set up.

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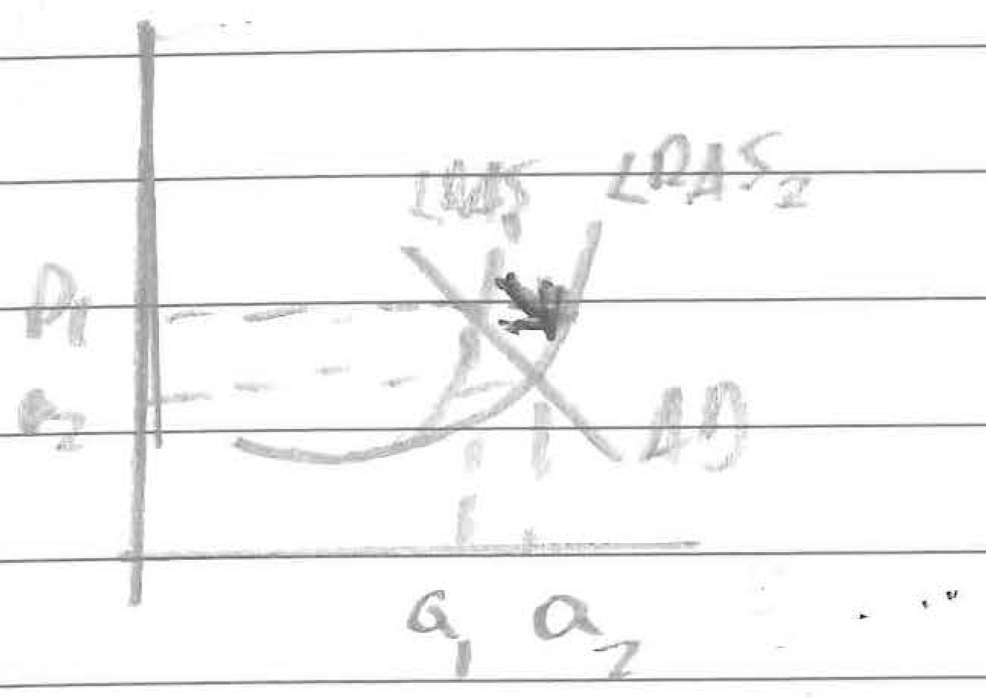


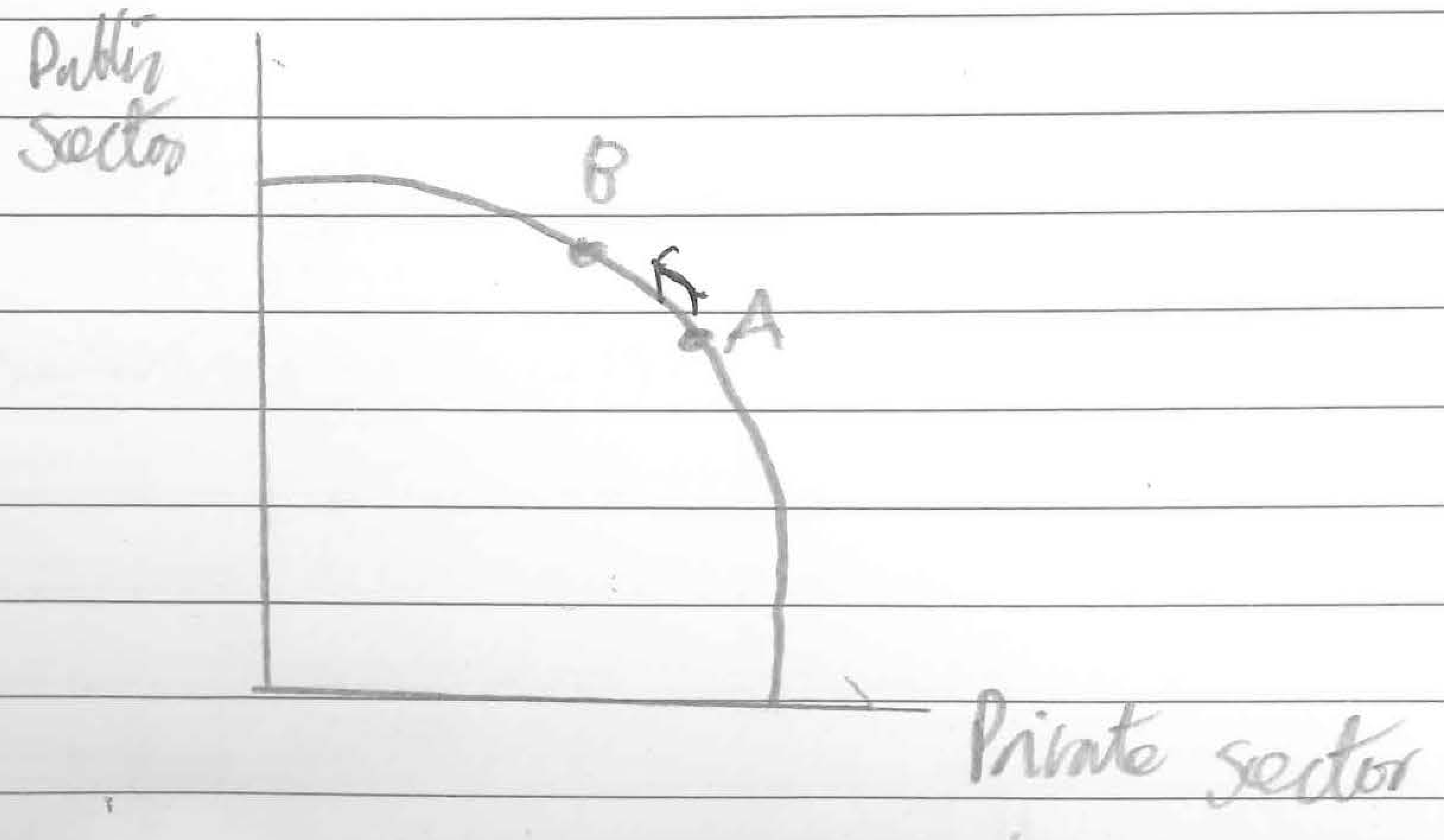
An increase in LRAS, could actualy lead to Benign deflation, which is beneficial for an economy.

However, a larger public sector deficit could mean that in the future there will be higher taxes, and because of rational expectations, people may realise that increased income because of less tax may not mean a higher real ~~income~~ income, only a nominal increase. If everyone thought "Rationally" consumption would not increase so AD may stay where it is.

Crowd

If a county is part of the EMU, then the budget deficit is not suppose to be higher than 3% Real GDP, so if ~~ours~~ rises higher than this, we may be seen as inefficient by other countries

Higher Goverment spending could also lead to crowding out, meaning less capacity for the private sector. It is argued the public sector are more inefficient than the private sector, so this could cause negatives for an economy, like higher average costs because the public sector don't profit maximise



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If the public sector debicit is decreased, then it'll mean in the long run, taxes could be lowered because of a smaller budget debicit.

·Higher Goverment spending won't necessarily effect AD or inflation. It depends on the population in an economy. If they believe in the life cycle model, then spending won't really differ because it depends on where in their life they are. Also Friedman's "Permanent income" model, means that people will only change spending patterns if their permanent ~~income~~ income changes. So relaxing the nation's purse strings could benefit an economy if it needs higher Goverment spending on vital public sector jobs.

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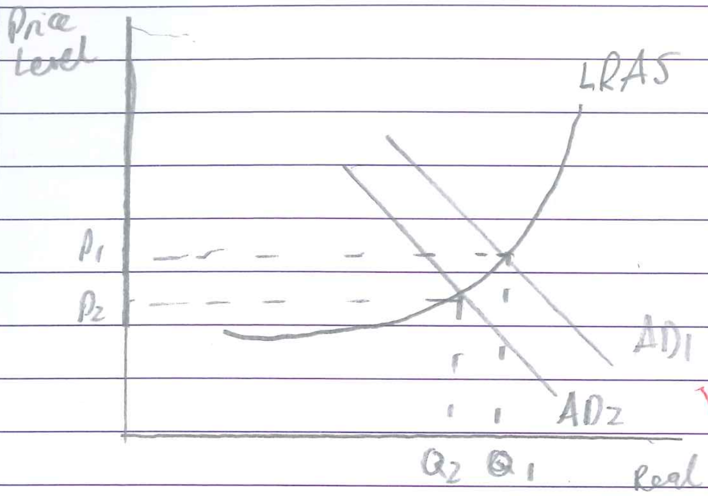

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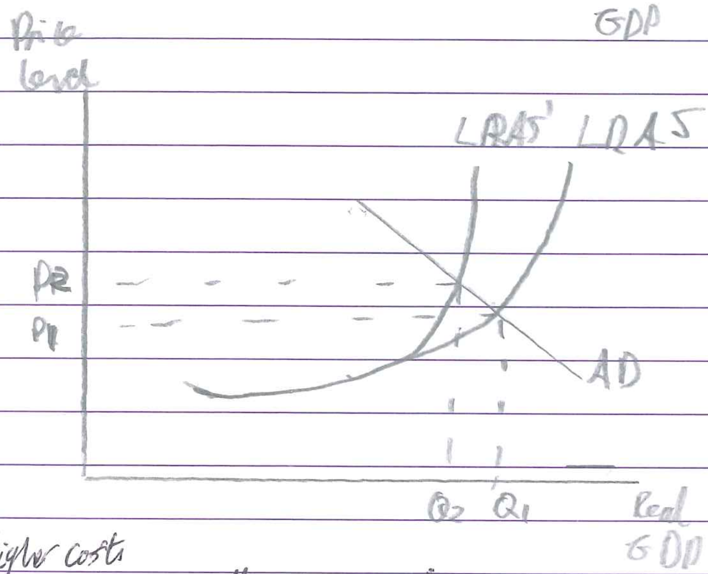

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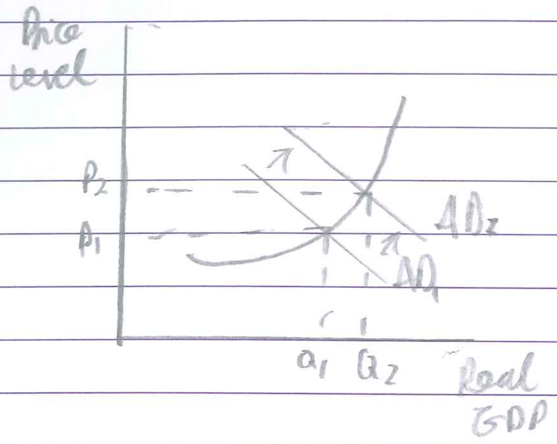

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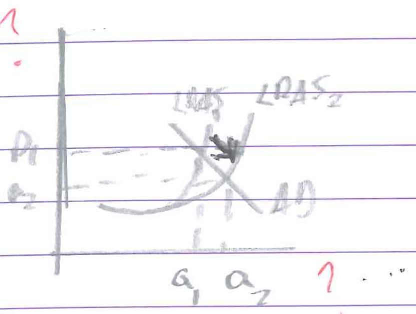

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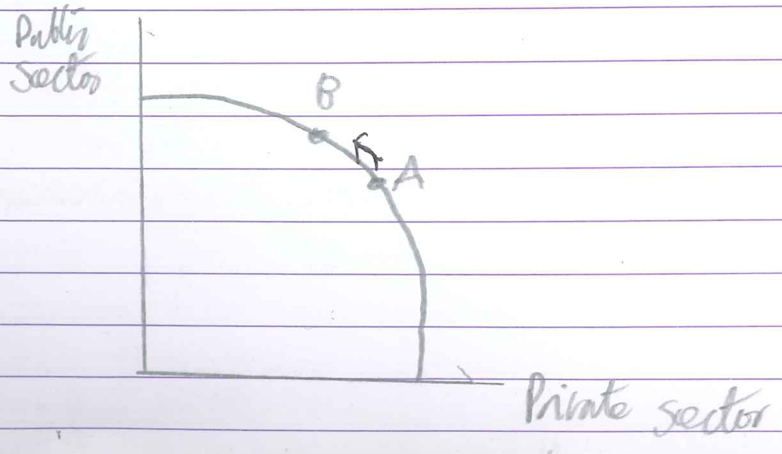

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SECTION B

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]

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3. ~~Reducing taxes~~

Cutting taxes, such as income tax, increases disposable income. While this may increase consumption in the UK economy, it is important to consider UK consumers Income elasticity of Demand for Imports. UK consumers YED for imports is ~~likely to~~ generally elastic. Therefore if consumers recieve an increase in disposable income, they may simply spend this income on imports. This will increase the UK's expenditure on Imports, possibly increasing the UK's trade deficit. If extra disposable income is spent on imports, then UK firms are unlikely to recieve and large increase in demand and therefore little increase in revenue and profits. Therefore the accelerator mechanism is likely not to have a large effect on increasing investment, so little increase in UK's productive capacity

Cutting taxes significantly may not lead to long term sustainable economic growth. Cutting taxes may simply lead to increasing levels of consumption, only producing short term economic growth. If the UK economy focuses its resources on producing consumer goods, this can drive resources away from producing capital goods, which are more productive and will lead to long term investment. If consumption

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is simply debt fueled, then this will reduce future economic growth rates, as consumers disposable income is reduced in the future, due to paying off debt, reducing future consumption

Cutting taxes substantially could lead to sudden demand pull inflation. As aggregate demand increases, pressure is placed on the UK's supply of goods and services, producing possible increases in demand-pull inflation. However, this may be unlikely due to the high level of spare capacity in the UK economy. Also, if cutting taxes increases investment, the long term effect ~~of inflation~~ on inflation will be reduced as the UK's productive capacity is increased.

Cutting taxes substantially leads to increases in consumption and investment, increasing GDP. However, ~~econ~~ increases in GDP are often at the expense of exploiting natural resources at an unsustainable rate. If natural resources, such as oil, are exploited at an unsustainable rate to fuel increasing GDP, then this will reduce the resources available to future generations, reducing future potential economic growth, therefore economic growth won't be sustainable or long term. However increasing

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GDP can be caused by increasing investment in more greener production processes, such as wind power. Investment in greener production will ensure long term growth for future generations.

In conclusion, cutting taxes is likely to lead to long term economic growth. While economic growth in the short term may be driven by higher consumer spending, through the accelerator mechanism, this will lead to investment, leading to increases in productivity and long term economic growth. However, methods such as reducing interest rates may be a more suitable method of producing long term economic growth as reducing interest rates doesn't involve ~~increases the government deficit to fuel economic growth~~ increasing the government deficit to fuel growth.

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14

More diagrams would be helpful to the explanations.

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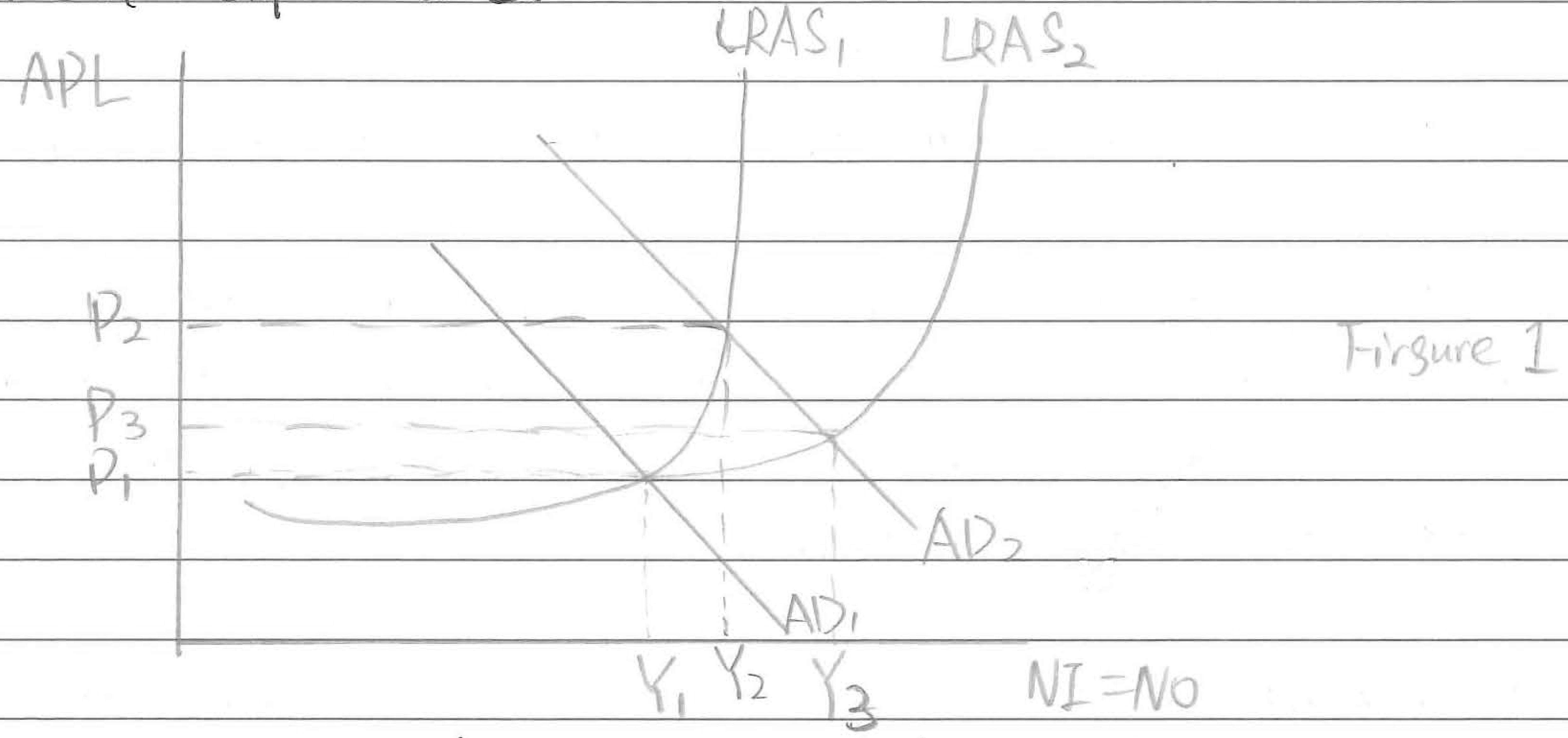
3. Long-term economic growth is ~~the~~ defined as the rate of change in GDP figure in the long run. The cut in all taxes is the expansionary fiscal policy to boost economics growth, but reduce the taxation ~~and~~ and increase the government expenditure.



When there is a decrease in ~~indirect~~ direct taxes, including income tax and coporation tax, there may be a rise in both consumption (C) and investment (I), because consumer and business now have more money to spend instead of paying tax to the government. Therefore, AD will shift to the right, because (AD = C + I + G + (X−M)) to AD_2, there is higher national output at Y_2, but higher average price level at P_2 as well. The cut in the direct taxes also boost the incentives for people to go to work, the quantity of labour might increase, because they need to pay less income tax, the real income of the workers increases. The quaility or quantity increase in the 4 factors of production might shift the LRAS curve outward, with higher productive capacity (economics growth) with lower ADL at P_3 (lower inflation). It can reach ~~economic~~ the long-run economic growth with out inflation. The national output now is even higher at Y_3 with less unemployment and lower ADL.

The decrease in indirect taxes reduce the costs of production for firms, especially for capital based firms. For instance, a fall in the indirect taxes for oil, manufactoring

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firms can reduce their costs and spend more on investment. This might shift the LRAS curve to the right or shift the PPC curve ~~out~~ outward, which brings the long-run growth. ~~The~~ The firms can ~~have~~ benefits from the dynamic efficiency, which is the efficiency over time. For example, if ~~to~~ Apple now need to pay less indirect tax, they will have more money spend on R+D which might increase the phone quality and with development in the high technology, lower costs of the production, if these lower costs can pass on to the consumers, they will benefits by higher quality of product, but lower prices.

Also, indirect taxes is regressive for the society, it may widen the ~~lower~~ income unequalty in the society, cause the crime rate increase. Because higher ~~prices~~ indirect taxes such as on rice or sugar, they hit harder on the poor people, they can't afford the higher price, but these product's weighting is ~~heavie~~ heavier than the rich for their daily life.

On the other hand, the ~~i~~ reduce in ~~in~~ direct tax might cause a fall in the government revenue, because tax revenue decreases. And it's not suitable for the UK, because the British budget deficit is over 6% of the GDP. Large government deficit might reduce the confidence of consumers and firms. With a large debt of over 70% of GDP, UK's credit rating decreased from AAA to AA1, which might lead to a loss in FDI, because confidence overseas are low as well. Therefore, the decrease in both taxes might worsen the government budget deficit, it's not beneficial for the long-run growth, because the opportunity of getting investment, which can increase the productive capacity to promote futher growth in long-run is lower.

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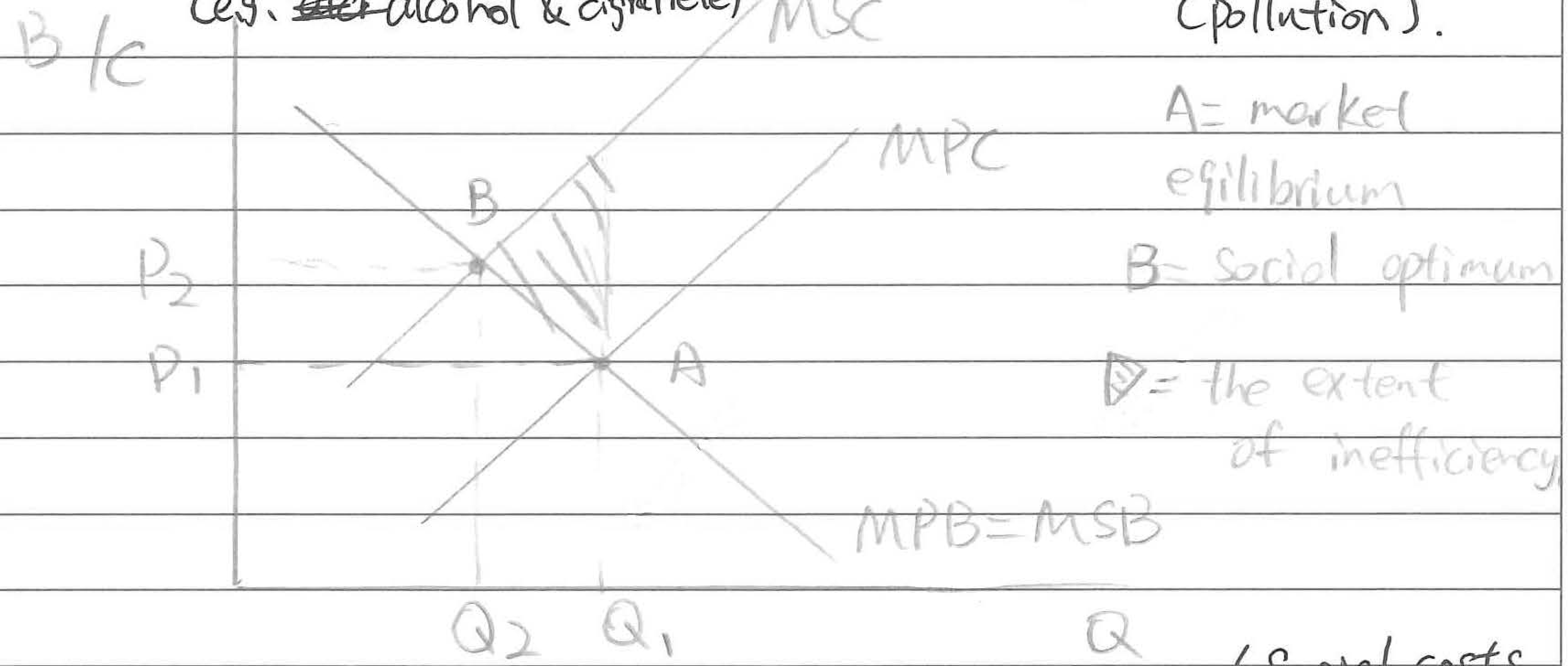
The rise in consumtion due to a decrease in direct tax might ~~cas~~ cause the import rises as well, because consumers have more money to spend on imports goods now. The decrease of (X-M), net exports might worsen UK's trade deficit ~~and~~ showing UK's goods and services are not competitive internationally.

A cut in indirect taxes can reduce the inefficiency of the policy which aim to solve the market failure — occurs when the market fail to allocate resources efficiently. The government induce indirect taxes to reduce the demand for demerit goods and reduce negative extenalities. (e.g. ~~etc~~ alcohol & cigarrete) (pollution).



To reduce the external costs in the market (Social costs ~~government~~ = private cost + external costs). Indirect taxes can reduce demand for demerit goods from Q1 to Q2, by rise the price from P_1 to P_2. Lower externalities help to economy to reach the social optimum, and makes the polluter pay.

In conclusion, the cut in all taxes is possibily to create long-run growth in the economy, but we need to judge each case individually. Especially at this time, UK has 0.8% positive GDP growth, it's competely out of recession, their main aims should shift from sustainable economic growth to rebalance the structure in the economy or lower the inflation.

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Maybe impove the current account deficit and government budget deficie as well.

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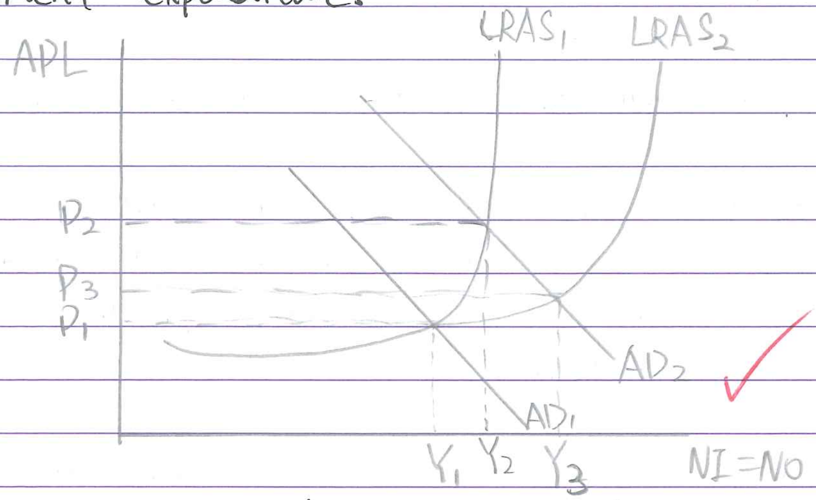
3. Long-term economic growth ~~is~~ defined as the rate of change in GDP figure in the long run. The cut in all taxes is the expansionary fiscal policy to boost economics growth, but reduce the taxation ~~and~~ and increase the government expenditure.



When there is a decrease in ~~indirect~~ direct taxes, including income tax and coporation tax, there may be a rise in both consumption (C) and investment (I), because consumer and business now have more money to spend instead of paying tax to the government. Therefore, AD will shift to the right, because (AD = C + I + G + (X−M)) to AD2, there is higher national output at Y2, but higher average price level at P2 as well. The cut in the direct taxes also boost the incentives for people to go to work, the quantity of labour might increase, because they need to pay less income tax, the real income of the workers increases. The quaility or quantity increase in the 4 factors of production might shift the LRAS curve outward, with higher productive capacity (economics growth) with lower APL at P3 (lower inflation). It can reach ~~economic~~ the long-run economic growth with out inflation. The national output now is even higher at Y3 with less unemployment and lower APL.

The decrease in indirect taxes reduce the costs of production for firms, especially for capital based firms. For instance, a fall in the indirect taxes for oil, manufacturing

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firms can reduce their costs and spend more on investment. This might shift the LRAS curve to the right or shift the PPC curve ~~out~~ outward, which brings the long-run growth. ~~The~~ The firms can ~~have~~ benefits from the dynamic efficiency, which is the efficiency over time. For example, if Apple now need to pay less indirect tax, they will have more money spend on R+D which might increase the phone quality and with development in the high technology, lower costs of the production, if these lower costs can pass on to the consumers, they will benefits by higher quality of product, but lower prices.

Also, indirect taxes is regressive for the society, it may widen the ~~income~~ income unequalty in the society, cause the crime rate increase. Because higher ~~prices~~ indirect taxes such as on rice or sugar, they hit harder on the poor people, they can't afford the higher price, but these product's weighting is ~~heavier~~ heavier than the rich for their daily life. Don't understand the point being made.

On the other hand, the reduce in ~~in~~direct tax might cause a fall in the government revenue, because tax revenue decreases. And it's not suitable for the UK, because the British budget deficit is over 6% of the GDP. Large government deficit might reduce the confidence of consumers and firms. With a large debt of over 70% of GDP, UK's credit rating decreased from AAA to AA1, which might lead to a loss in FDI, because confidence overseas are low as well. Therefore, the decrease in both taxes might worsen the government budget deficit, it's not beneficial for the long-run growth, because the opportunity of getting investment, which can increase the productive capacity to promote futher growth in long-run is lower.

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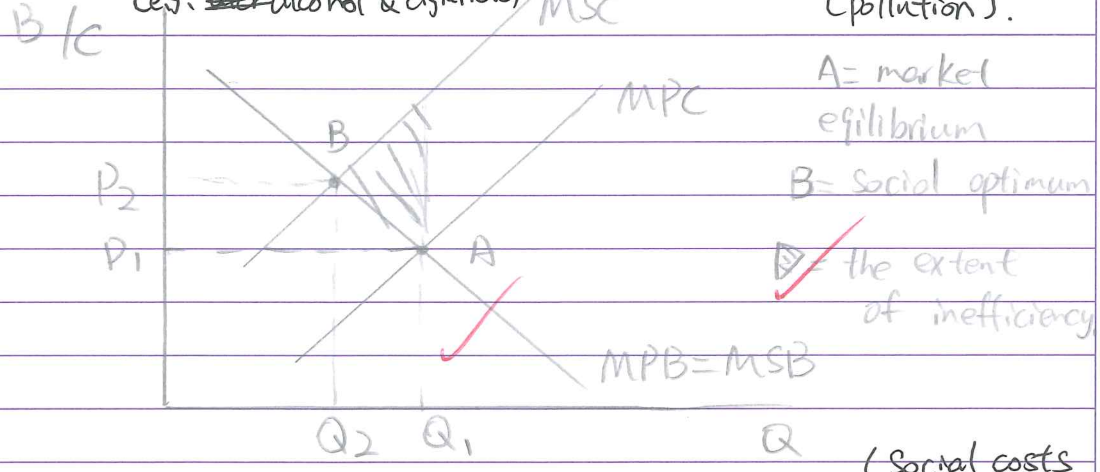

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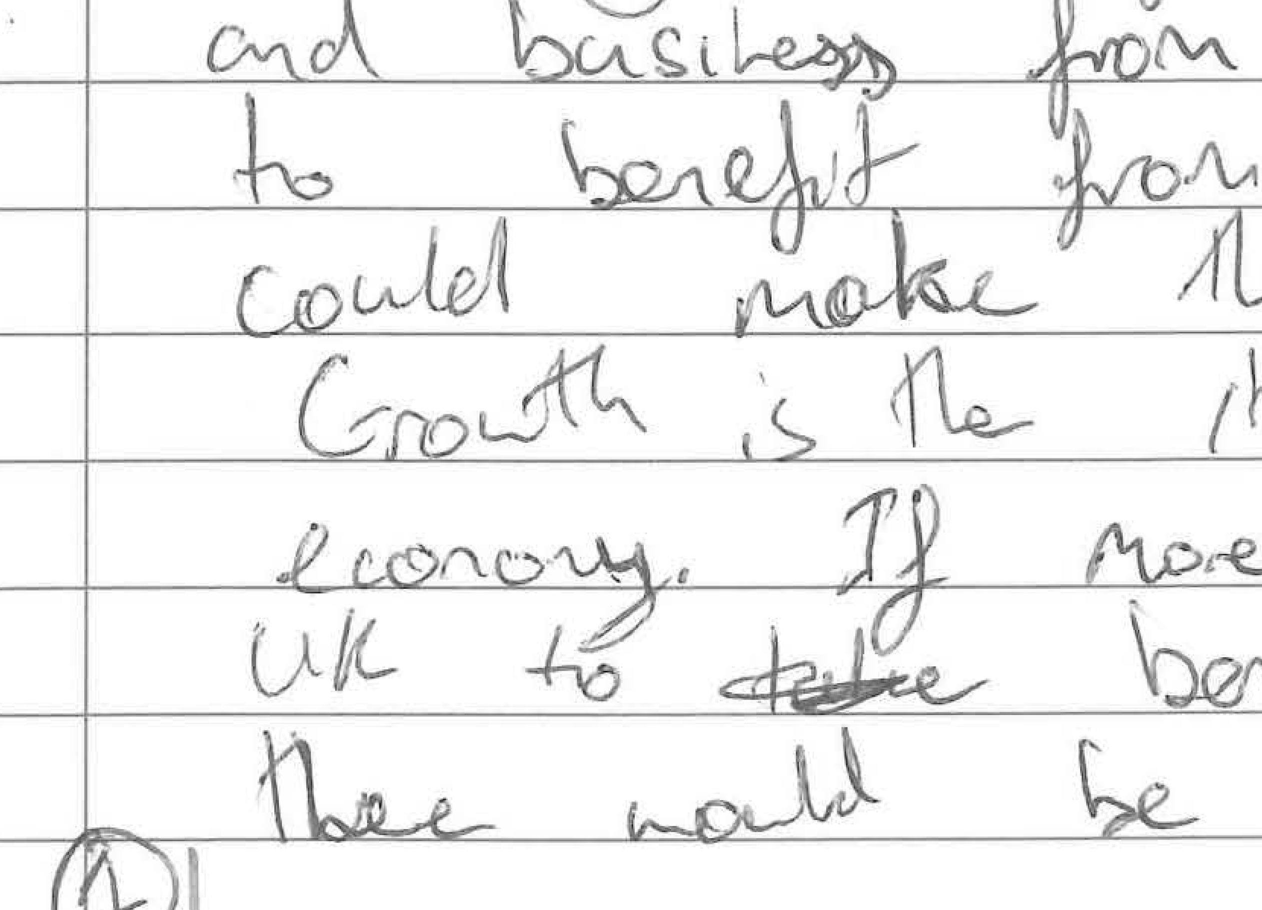
Clear explanations — accurate diagrams.

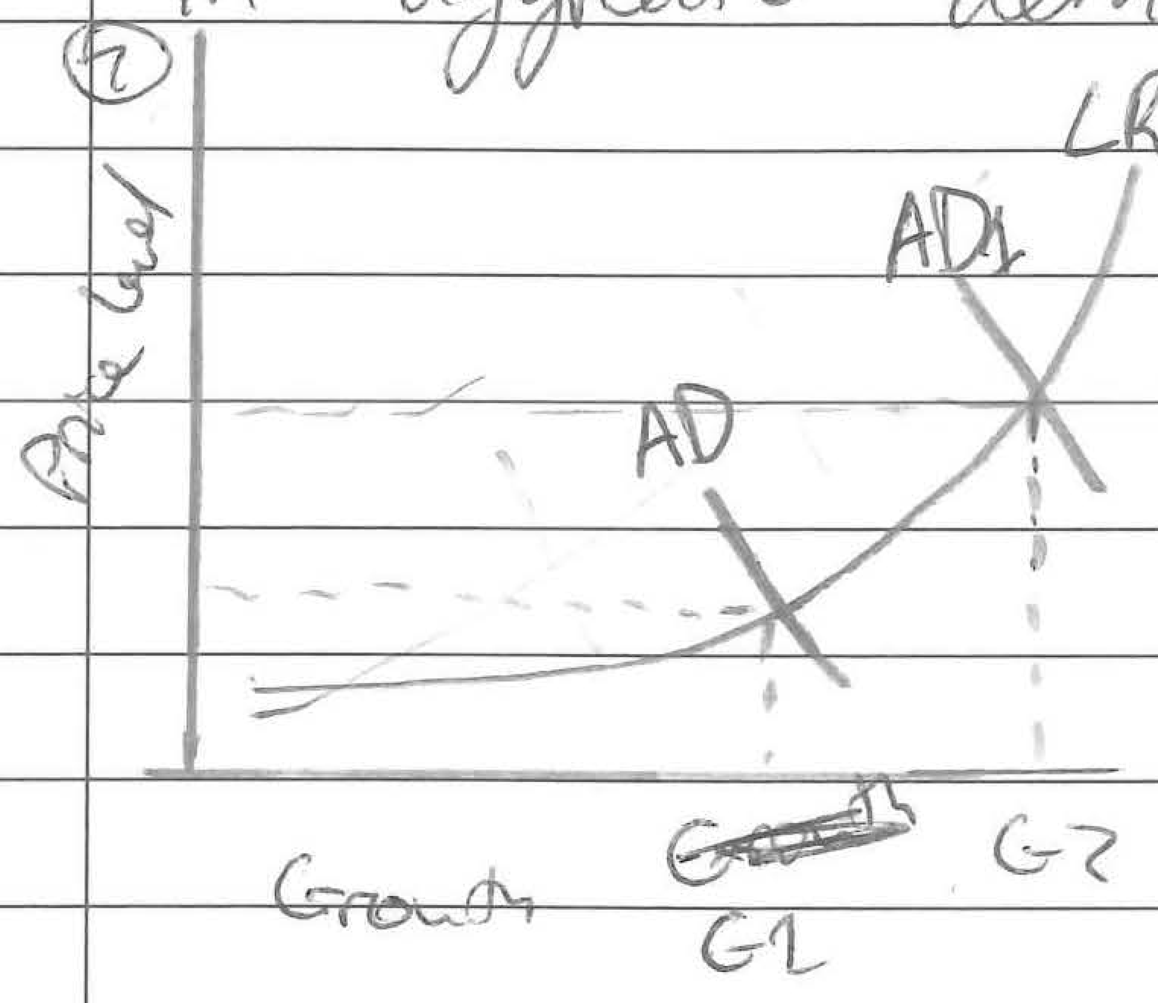
15

(3) A significant cut in taxes such as corroration tax which has been cut ~~to 18%~~ ~~22%~~ from 22% to 18% and income tax which is currently at 50% for many earners may generate huge growth in the economy through attracting both individuals and business from abroad ~~to~~ as they wish to benefit from low tax rates ~~as~~ which could make the UK a tax haven. Growth is the increase in the capacity of an economy. If more busiless moved to the UK to ~~take~~ benefit from the low tax rates there would be aggreate demand shown in diagram (1) a ~~ff~~ shift from AD to AD1 this shift results in ~~an~~ an increase of growth shown the move nent of G1 to G2.

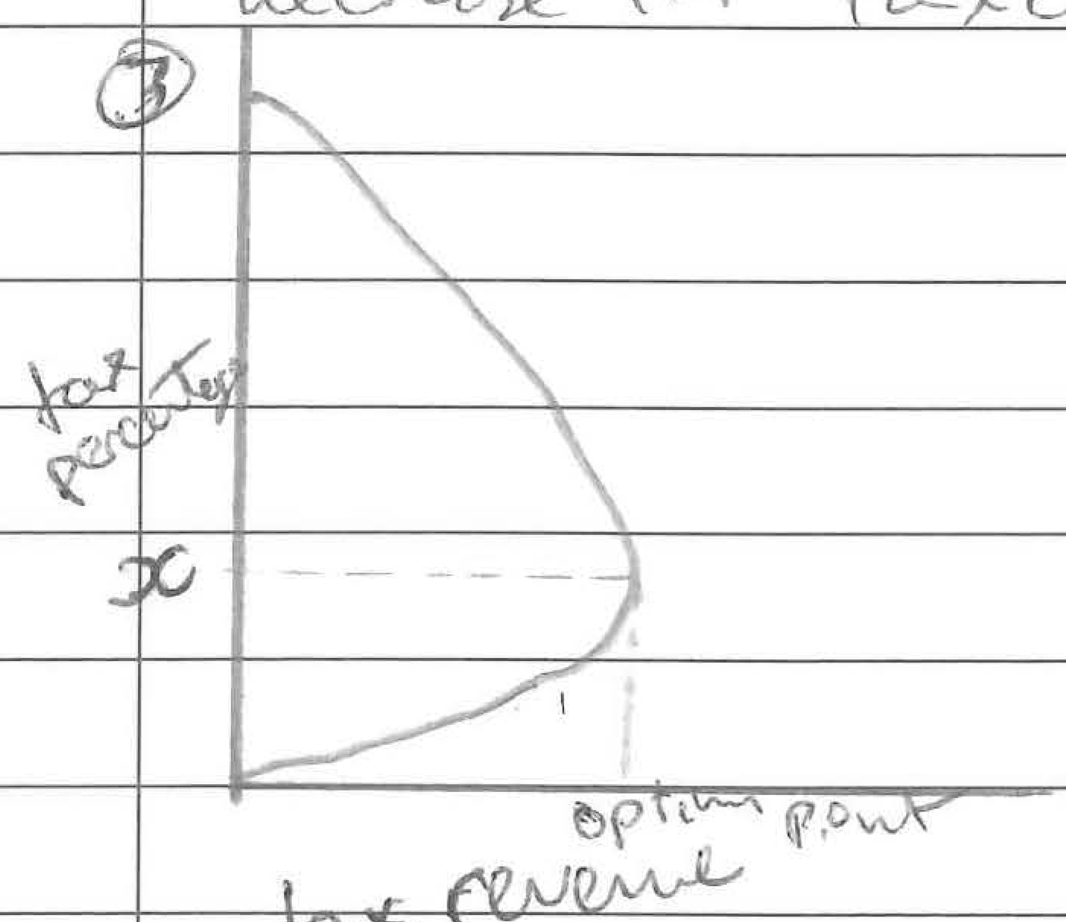
(1)



This therefor may help increase ~~to~~ growth in the UK from it's current figure of ~~£~~ 0·8% for the last quater and 1·8% for last year. Another way reducing tax rates could create long term growth is through peoples dispossible incomes increasing substainaly and business having large profits to invest in inferstructure this all results in ~~to~~ a large increase in aggreate demand ~~causing~~ shown in diagram



② ~~this therefore result~~ in the movent of AD to AD1 this therefore results in the economy growing ~~as~~ and GDP increasing the goverment could also make back a large amount of tax revenue lost through the decrease in taxes through indirect taxes such as VAT. decreasing taxes could also benefit the economy through tax revenue rising as due to tax rates falling less people avoid tax this is ~~by~~ shown in diagram ③ ~~with the~~ ~~increase~~ the laffer curve with the optim tax point being at the lower end.



The manipulation of tax ~~tax~~ rates ~~is an~~ to stimulate growth which is an example of fiscal policy which is when ~~the~~ goverment manipulates taxes and ~~spend~~ goverment spending with the aim of stimulating growth. A reduced tax rate would also encourage companies such as Starbucks to stop ~~a~~ avoiding tax through tax havens ~~and~~ and such resulting in growth in the UK economy as less countries are registered to off shore tax havens.

There are various ~~after~~ other ways of

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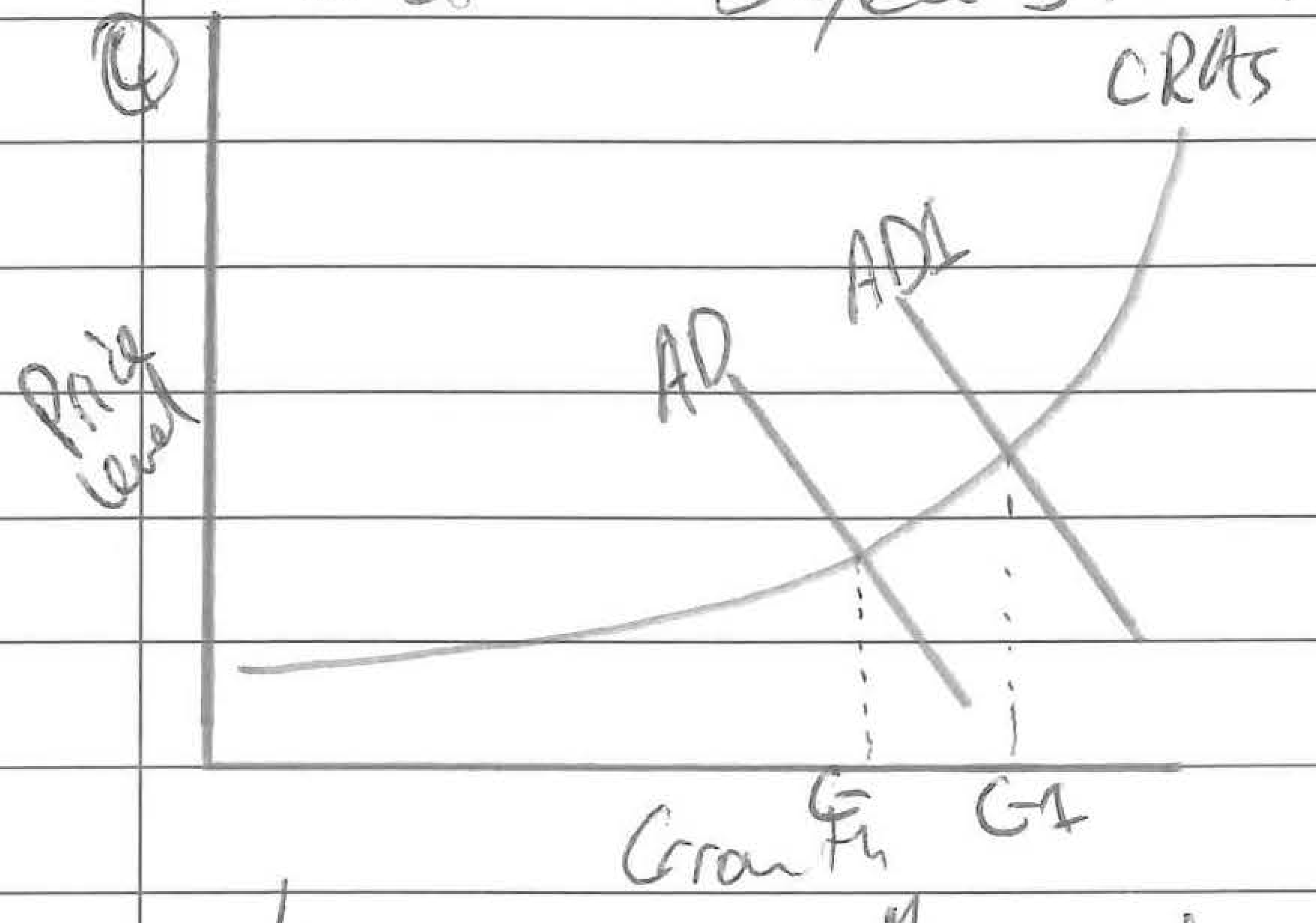
(4)



~~~~ as if there is a low interest rate borrowing is cheap so aggreate demand increases as cheap credit is avaible, aggreate demand and therefore growth also increases due to low interest rates as ~~there~~ ~~is~~ a return for ~~~~ saving is low there for encouraging people and ~~to~~ companies to spend this causes the shift of AD to AD1 in diagram (4) which results in increased growth.

The use of monetary poliy to stimulate growth over fiscal policy is benefical as it does not cost the goverment anything to manipulate the ~~exchange~~ interest rates while a reduction in tax rates costs the goverment a huge amount in both ~~~~ loss in potential tax and ~~~~ administation costs. there fore reducing tax rates ~~is~~ significantly at ~~of~~ a time of large budget deficit such as ~~~~ we have currently can damage the economy hugley due to loss in goverent revenue which restricts future growth due to loss of capital ~~to~~ to invest in infastructure.

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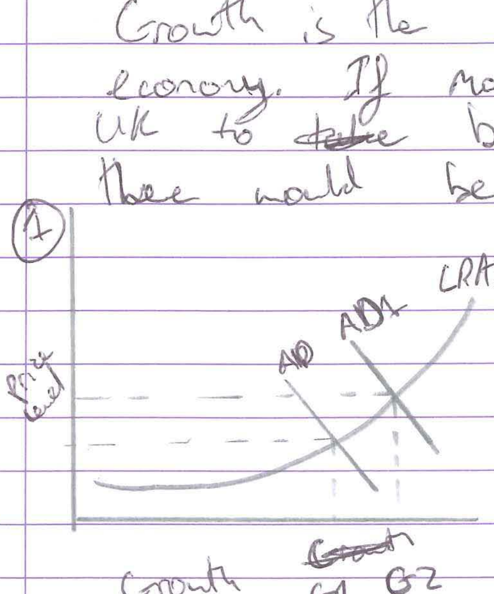

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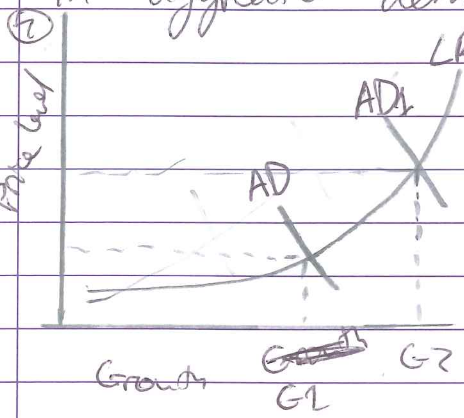
① 

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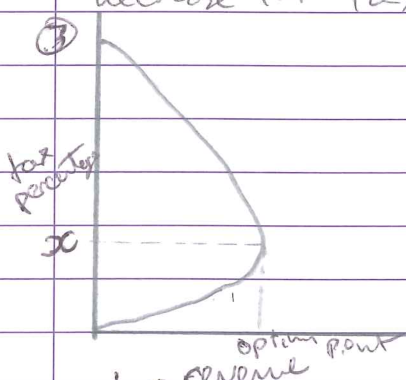
③ 

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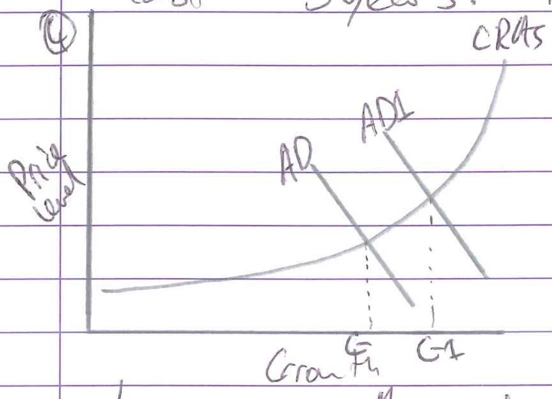

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