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Revision Note

AS Economics

Anticipated Questions

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The 3 most anticipated 30 marks essay questions

A. Economic policies to boost growth

1. Bank of England reduces interest rates, cheaper borrowing, increase in consumption and investment, AD increases, rise in real GDP hence growth

Evaluation: Contradicts with one of the macroeconomic objectives. Higher growth but also accommodated by higher inflation

2. UK government may want to increase spending into the economy, direct injection, shifts AD rightward, actual growth is achieved. Through multiplier effect growth may be higher when jobs are created both in public and private sectors

Evaluation: UK government is already saddled by heavy debts. Budget deficit and national debt at record high level and due to the commitment to EU laws, instead of pursuing expansionary fiscal policy, the UK government may have to do the otherwise

3. Reducing income tax, greater disposable income, more money can be spent into the economy, kick start economic activities, rise in real GDP and growth is achieved

Evaluation: May not be a smart move due to poor government finances. Also have to consider that in future, it can be very politically sensitive to raise back the tax rate once economy recovers

4. Privatisation, private firms have profit motive and hence are more competitive and innovative, more goods and services produced over the time, growth achieved

Evaluation: not much space for further privatisation. Most state-owned enterprise had undergone privatisation during the era of Conservatives. Robust growth can no longer be achieved using such policy

5. Deregulation/ liberalisation, opening up the market for more competition/ allowing for more free market forces e.g. greater number of firms, more output produced and hence growth

Evaluation: depends on number of firms in the market. Conspiracy/ price fixing may still take place where companies try to cut output in order to send prices skyrocket. Growth may not be achieved

6. Education and training, UK will have more knowledgeable and skilled workers, rise in productivity and efficiency, AS shifts to the right, greater output and hence growth

Evaluation: Few obstacles in the way. First, it is increasingly difficult to raise budget onto education sector given the current state of government finances. Budget deficit has to be brought under control. Second, it is extremely long term in nature e.g. two decades once graduates enter labour market. Third, there is no guarantee that potential growth can be achieved as there are some factors that are out of control e.g. brain drain of professional workers to English speaking nations

7. Lower income tax, employees get to keep greater portion of their income, creates the incentive to be productive, more output and growth is achieved

Evaluation: May be dominated by income effect. Lower income tax allows workers to achieve their targeted disposable income effortlessly. May not have the motivation to work hard

8. Lower business tax, higher retained profits, companies more likely to invest e.g. new equipments, greater efficiency, more output and growth

Evaluation: No guarantee that firms will invest especially when the economy is still far from full recovery

9. Labour union reforms, further restriction on the ability to launch strike, more productive working days in a month/ year, more output produced and hence growth

Evaluation: If their rights are denied e.g. fight for just-pay and other benefits, they may equally lose the incentive to be pro-active at workplace. Output may fall

10. Reduction of unemployment benefits, reduce the incentive to stay unemployed, more jobless people getting back into labour market, more output produced, increased in growth

Evaluation: That is assuming other factors are constant. In reality this may be futile. For instance e.g. their skills may not be relevant or no vacancies due to economic recession. Either way, their attempts are trivial. Output growth is denied

11. Increased spending on facilities and transports e.g. more roads and better condition, reducing congestion and allow people/ firms to make more trips per day, rise in productivity since people can reach workplace earlier and

companies can have more business transactions per day, rise in goods and services and therefore growth

Evaluation: Worsening budget deficit means slash in public spending and transport is likely to be affected

B. Economic policies to reduce inflation

1. Higher interest rates, more expensive to borrow, lower consumption and investment, AD shifts leftward, lower price level and inflation

Evaluation: Highly effective only if the inflation is demand-pull in nature. If it is due to cost-push, such policy will only backfire. Growth will come to a stand-still and unemployment will increase

2. Cut in public spending, lesser injections into the economy, fall in AD, lower inflation, through negative multiplier effect the income of both public sector workers and private firms is lowered, reduce the ability to spend, even lower inflation

Evaluation: Politically unpopular and current government may lose votes in next election. Besides, inflation is still within the manageable range and government should focus more on boosting recovery

3. Rise in income tax, lesser disposable income, less money to be spent back into the economy, hampers consumption, fall in AD, lower inflation

Evaluation: Politically unpopular. Also, is less effective since the nature of inflation is caused by increased in prices of energy

4. Privatisation, companies have profit motive and the industry will be very competitive, greater tendency to run operation more efficiently since this can boost profits and enlarge market share, fall in costs can be passed in the form of lower price, fall in inflation

Evaluation: Not much room for privatisation. A good policy but no longer viable

5. Deregulation, allowing for more market force, rise in competition ensures that prices can be kept low, fall in inflation

Evaluation: May be futile if the firms are operating under oligopolistic structure. Can easily collude and fix high prices and hence denying the free market force

6. Education and training, workers become more knowledgeable and skilled, costs are spread over greater output, lower unit cost, cheaper price and hence lower inflation

Evaluation: Very long run. May not have visible effects within 20 years, not until graduates have entered the labour market. Also, other factors may undermine the success e.g. weak pound and high energy prices

7. Reducing income tax, workers get the incentive to work harder and the possibility of taking up second job, greater productivity and hence lower unit cost, inflation is under control

Evaluation: No guarantee that productivity will increase due to income effect. Also, firms may not want to pass on the cost-saving

8. Cut in business tax, companies have greater retained profits, more likely to invest in cutting-edge technology, greater efficiency and lower costs, passing on in the form of lower price, inflation is kept within the targeted range

Evaluation: Companies may not want to invest if consumer confidence remains low

9. Reduction in unemployment benefits, jobless people have greater incentive to take up low-paid jobs, rise in competition for jobs, wages can be kept low, lesser cost-push inflation

Evaluation: Depends on whether wages made up a large proportion of total costs. Also, strength of pound and energy prices can undermine the success of this policy

10. Weakening the trade union, passing on laws to make strikes difficult, lesser days lost to strikes, minimise losses and costs, cheaper price and hence lower inflation

Evaluation: Productivity may fall if they know that the most vital right is being taken away. Not a proper way to reduce inflation

11. State-of-art healthcare system, working people take lesser sick leaves and can contribute more productively in workplace, more output produced allowing high costs to be spread over, lower unit cost and hence inflation is tackled

Evaluation: Requires huge government spending and under the current state of economy such policy may be considered as too 'ambitious'. Also, there could be opportunity cost in terms of spending in other areas e.g. education and transports that can equally affect movement of AS

C. Economic policies to reduce current account deficit under the balance of payments

1. Increase in interest rates, more expensive to borrow and spend, economic activities slowing down, possibility of lower wages or slowdown in wages growth, lesser money that can be spent on imports, narrowing the deficit under current account

Evaluation: more attractive to save in UK banks. Demand for sterling increases causing pound to appreciate. Exports artificially expensive and US, France and Germany may stop buying from UK. Deficit cannot be narrowed

2. Cut in public spending, fall in AD and hence slower growth, income level may be falling and hence lesser imports, through negative multiplier effect imports may fall to a greater extent

Evaluation: Other factors not constant. For e.g. if pound appreciates against euro or dollar, still imports will rise and current account deficit cannot be narrowed

3. Increase in income tax rate, lesser disposable income, less money that can be spent onto buying imports, narrowing of current account deficit

Evaluation: Strength of pound and strong performing housing market may undermine such success

4. Rise in corporate tax, lower retained profits, companies may be cutting investment, lesser imports of capital goods e.g. machines from Germany or Japan, reducing current account deficit

Evaluation: May not be effective if consumer confidence is strong, housing market is fast recovering and pound is appreciating. People and firms will still continue to invest

5. Education and training, workers become more skilled and efficient, improvement in quality of goods produced and at lower costs, competitive pricing and hence greater exports, narrowing current account deficit

Evaluation: strengthening pound may undermine the success of this policy. Also, there is no guarantee that the training programmes will be effective in boosting productivity

For the rest of supply side policies, the transmission mechanism is exactly the same except that you have to do some modifications. For example, instead of 'lower costs *and hence lower inflation', you write 'lower costs and hence lower price/ more competitive pricing for international market'*