Pearson Edexcel Level 3 GCE

Sample assessment material for first teaching September 2015

Time 1 hour 30 minutes

Paper reference **8EC0/02**

Economics A

Advanced Subsidiary

PAPER 2: The UK economy – performance and policies

Source Booklet

Do not return this Booklet with the question paper.

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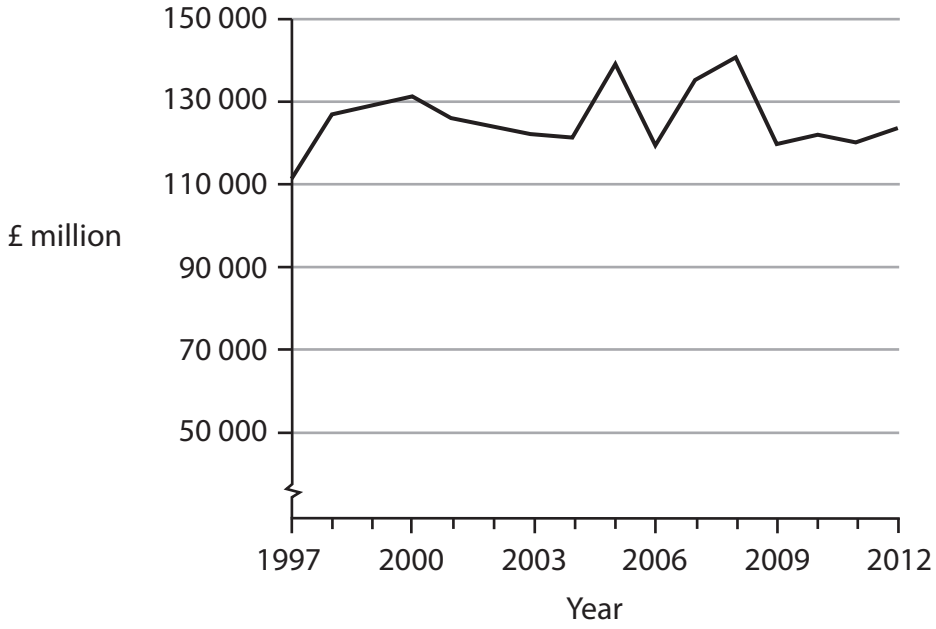
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Sources for use with SECTION B

Read the following figures (1–2) and extract (A) before answering Question 6.

UK consumption, investment and trade

Figure 1: UK real annual business investment, 1997–2012 (seasonally adjusted)



(Source: http://www.ons.gov.uk/ons/rel/bus-invest/business-investment/q3-2013-provisional-results/stb-business-investment-q3-2013-provisional.html#tab-Business-Investment-and-other-components-of-GFCF)

Figure 2: British pound (£) to US dollar ($) exchange rate, 1 January 2013 to mid-February 2014



(Source: http://www.tradingeconomics.com/united-kingdom/currency)

Extract A

Why Britain needs a pay rise

UK growth in 2013 has been caused mainly by increases in consumption. Rising consumption tends to encourage companies to invest. The increase in demand for goods and services means firms need more productive capacity, often moving to bigger premises and buying capital equipment. Crucially, though, they only do so if they think the increase in consumption is likely to be permanent.

At the start of 2013, it was hard to see why consumer spending would rise. The economy had recorded little growth for two years and confidence was low. Inflation had been higher than earnings growth during 2012, making it hard for families to manage.

Three factors combined to change the picture: cheap credit, the Bank of England's funding for lending scheme (FLS), and rising consumer confidence. The Bank of England cut its official interest rate to 0.5% in early 2009, but it took a long time for the monetary stimulus to have an impact.

It only really did so when FLS was announced in the summer of 2012. This was a deal under which the commercial (high street) banks could borrow more cheaply from the Bank of England provided they passed on the benefits to their customers.

The idea was that household and business borrowers would benefit: loans would become more readily available and the interest rates charged on them would be lower. Lending to businesses was disappointing, but the impact on the mortgage market was rapid and significant: more mortgages were approved, and at lower rates of interest. This contributed to the improvement in the housing market, which in turn boosted confidence, leading to higher spending, and this led to higher growth.

Consumers ran down their savings to fund this higher spending. Again, this is not unusual. Households become more cautious in troubled times and they save more just to be on the safe side.

However, unless consumers are willing to save less and less and borrow more and more, there is only so long this process can continue. Eventually, consumer spending growth has to be the result of rising real incomes rather than falling savings.

After a year in which the consumer has been the driving force behind the expansion of the economy, 2014 should be the year when investment contributes to growth. Many of the conditions for an increase in business spending are in place: companies are cash rich, profitability is good, interest rates are set to stay low, and ageing capital stock needs replacing.

The one factor not in place is the most important one of all: an increase in real wages. If companies believe that consumers will carry on spending, they are much more likely to go ahead with new investment projects. If they think consumer spending will not increase, then they will be unwilling to invest. This will mean that inflationary pressures build up and the trade deficit will continue to widen.

(Source: adapted from 'Why Britain needs a pay rise', Larry Elliott, The Guardian, 29 December 2013 http://www.theguardian.com/money/2013/dec/29/why-britain-needs-pay-rise)

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