



**AS ECONOMICS**  
**COMPONENT 2**  
**Exploring Economic Issues**  
**SPECIMEN PAPER**  
**2 hours**



**ADDITIONAL MATERIALS**

In addition to this examination paper, you will need a calculator and a 20-page answer booklet.

**INSTRUCTIONS TO CANDIDATES**

Answer all the questions.

Use black ink or black ball-point pen.

Do not use pencil or gel pen.

Do not use correction fluid.

**INFORMATION FOR CANDIDATES**

The number of marks is given in brackets at the end of each question or part-question.

No certificate will be awarded to a learner detected in any unfair practice during the examination.

## 1. THE UK CAN'T SEEM TO ESCAPE ITS TRADE DEFICIT

Exports have reached record levels, but so have imports – and some economists say the UK economic recovery will only make the gap grow.

Whatever happened to the UK's promised export boom? Well, exports of goods are up to £304.3bn billion in 2013 from £300.5 billion in 2012 and have reached record levels, but goods imports have also exceeded previous highs, rising to £412.6bn in 2013 from £409.2bn in 2012. We continue to import more than we export.

Some economists argue that the trade deficit should be down to zero after the severe recession: a proper recession, that reduces national output and people's incomes usually cuts the import bill dramatically, a situation we can see in Greece and Portugal.

In the UK, however, the Keynesian response to the crisis in the UK started by Labour and partially continued by the coalition government supports employment and public services, but also has the effect of keeping levels of imports high. That's why a significant jump in exports is needed if the trade deficit is to fall.

However, despite a 25 per cent fall in the value of sterling during the recession, the rise in exports was only slight. Our reliance on selling to the EU, which has struggled to grow since 2008, is one reason, as is the large and growing productivity gap between the UK and its leading competitors. The economy's dismal record on investment (see charts) and the recently proposed rise in the national minimum wage are unlikely to help either, especially when faced with competition from low wage economies abroad.

In days gone by, countries might have resorted to protectionist measures such as tariffs and quotas to reduce the deficit, an option not available to the UK because of its membership of the EU. But even if the UK could increase tariffs, most economists think that although protectionist measures such as tariffs can be good in the short run for protected businesses, raise revenue for the government and increase wages levels, they are generally economically damaging in the long run.

Figure 1  
GDP per worker, G7 countries

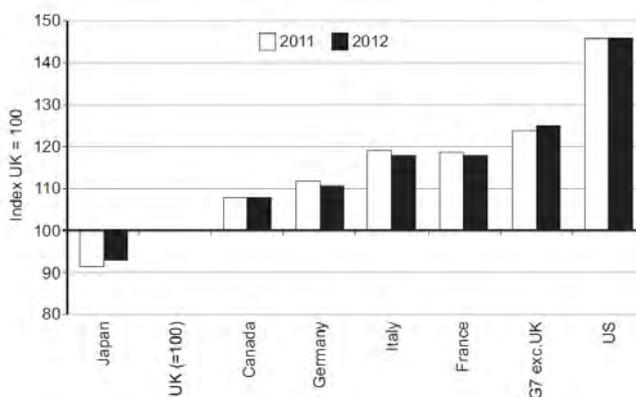
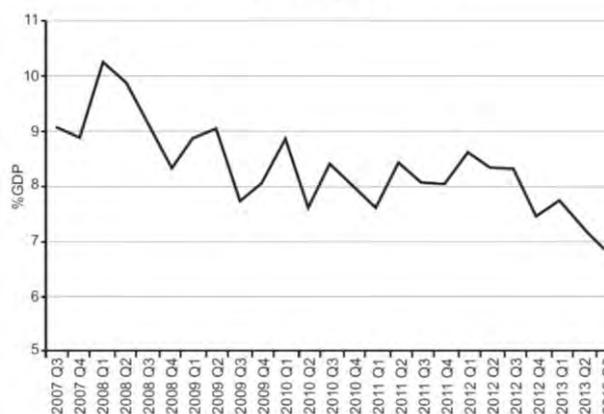


Figure 2  
Investment spending by UK Businesses



Part of the UK's response has been to try to improve the supply side performance of the economy, to allow UK firms to become more competitive (see insert on Budget 2013).

#### Budget 2013

The government is delivering an ambitious programme of supply-side reform to equip the UK to succeed in the global race. The government will:

- Make the UK tax system one of the most competitive in the developed world by reducing corporation tax, so it reaches 20 per cent in April 2015.
- Increase capital spending plans by £3 billion a year from 2015-16.
- Provide £1.6 billion of funding to support 11 key industries. From this fund the government, will create an Aerospace Technology Institute, which will provide a total of £2.1 billion of research and development support over seven years.

However, the UK has had a trade deficit for most of the last 30 years – this is a problem that clearly does not respond quickly to policy changes.

- (a) (i) Calculate the change in the UK trade deficit between 2012 and 2013. [2]
- (ii) Using the data, explain why the UK's trade deficit remains high. [6]
- (b) (i) Using a supply and demand diagram, explain why the imposition of a tariff might raise wage levels. [6]
- (ii) Discuss whether an increase in tariffs by the EU is likely to be good for EU economies. [10]
- (c) Discuss whether a rise in the national minimum wage would be likely to worsen the UK's trade position. [8]
- (d) With reference to the data and figures 1 and 2, discuss how effective the plans announced in the 2013 Budget are likely to be in eliminating the UK's productivity gap with its major competitors. [8]

## 2. UNPOPULAR TAX RAISES COSTS OF FLYING

Over the last twenty years as incomes have risen and the world has become more accessible thanks to globalisation the demand for air travel has risen significantly. Air fares have become progressively cheaper in relation to wages. At the same time the number of airlines competing for flyers' custom has also risen with the entry to the market of budget airlines such as easyjet and Ryanair. Parts of the world have also now been opened up to travellers i.e. China, Cuba and Eastern Europe. Compared to the early 1990's the number of flights and passengers have soared. Since 1990 passenger numbers in the UK have increased by 113 per cent while the International Civil Aviation Organisation projects that passenger numbers will most likely grow at 4.5 per cent per year until 2030.

Although planes are becoming less noisy, more fuel efficient and less damaging to the environment air travel is the world's fastest growing source of greenhouse gases like carbon dioxide, which cause climate change. Globally the world's 16,000 commercial jet aircraft generate more than 600 million tonnes of carbon dioxide (CO<sub>2</sub>), the world's major greenhouse gas, per year. Indeed aviation generates nearly as much CO<sub>2</sub> annually as that from all human activities in Africa. Governments feel obliged to be seen to be taking action to control these 'spill over' effects resulting from air travel. In the UK the government introduced Air Passenger Duty in 1996 when the reduced rate was only £5 in Band A.

Figure 1  
NEW AIR PASSENGER DUTY FROM 1 APRIL 2014

Bands (approximate distance in miles for the UK)	Reduced rate (lowest class of travel)		Standard rate (other than the lowest class of travel)		Higher rate	
	From 1 April 2013	From 1 April 2014	From 1 April 2013	From 1 April 2014	From 1 April 2013	From 1 April 2014
Band A (0- 2000 miles)	£13	£13	£26	£26	£52	£52
Band B (2001- 4000 miles)	£67	£69	£134	£138	£268	£276
Band C (4001- 6000 miles)	£83	£85	£166	£170	£332	£340
Band D	£94	£97	£188	£194	£376	£388

Air Passenger Duty is an excise duty which is charged on the carriage of passengers flying from a United Kingdom airport. Imposed on airlines it can be passed on in total or in part to passengers and forms part of the UK government's policy to reduce CO<sub>2</sub> emissions. Aviation currently accounts for around 6 per cent of total UK greenhouse gas emissions. The UK already has the highest Air Passenger Duty in the world and it has been alleged that it has already cost 25,000 UK travel industry jobs. Virgin Atlantic has made the decision not to pass on what it calls an "unfair retrospective" duty increase in 2012 to passengers, according to a letter by CEO Steve Ridgeway. The tax earns £4.0bn per year for the Treasury and some airlines claim that they have had to scrap routes as a result of the tax – particularly British Airways who have cut several flights to the Caribbean.

The government says in its defence of the tax that the airlines pay no VAT on fuel or on ticket sales and thus the tax is not a huge burden on either airlines or passengers. However, a recent study by the accountants PwC claimed that if Air Passenger Duty was abolished 60,000 jobs would be created, GDP would be boosted by 0.46 per cent and net tax revenue would actually rise by £480m. It has also been argued that Air Passenger Duty actually increases emissions because travellers are drawn towards taking connecting flights via other European airports rather than flying direct, so as to avoid the tax.

- (a) Using figure 1, calculate the percentage increase in Band A APD from 1996 to 2014. [2]
- (b) Using the data, and with the aid of a supply and demand diagram, explain why passenger numbers have increased in recent years. [6]
- (c) Comment on the income elasticity of demand for air travel. [4]
- (d) Using examples from the data explain the meaning of
- (i) government failure [4]
  - (ii) external costs. [4]
- (e) How far do you agree with the view that Air Passenger Duty is the best way to reduce the external costs arising from air travel? Use a diagram to illustrate your answer. [10]
- (f) In recent months the exchange rate of the pound has risen and in January 2014 climbed to \$1.6615 against the US dollar - a two-and-a-half year high. Discuss the effect of this rise in the pound on UK airlines such as British Airways and easyjet. [10]