

### **Question 1 The UK Productivity Puzzle – Did productivity really fall?**

**(a) (i) With reference to Figure 1, state the relationship between output growth and employment growth in the UK from 2000 to 2009. [1]**

- positive / direct relationship / move in tandem

**(a) (ii) Suggest possible reasons for this relationship. [2]**

- Higher output growth  $\Rightarrow$  more workers needed  $\Rightarrow$  higher employment growth
- higher employment growth  $\Rightarrow$  more people have jobs  $\Rightarrow$  higher income  $\Rightarrow$  higher C  $\Rightarrow$  higher AD  $\Rightarrow$  higher output growth

**(b) (i) State what happened to the level of productivity observed in the UK economy during the “job-rich depression”. [1]**

- During a “job-rich depression”, output falls yet employment stays strong. Hence, output per worker falls, leading to a fall in productivity observed.

**(b) (ii) Explain why this “job-rich depression” might not currently be a concern for the British government. [6]**

- Rising employment despite falling output  $\Rightarrow$  could avoid problems such as falling SOL, loss of skills, fiscal costs, social costs, etc typically associated with recessions
- Rising employment  $\Rightarrow$  could potentially boost C and support economic recovery (AD)
- If the situation is mainly caused by labour hoarding and a flexible labour market, output can increase quickly when demand recovers  $\Rightarrow$  it can propel the economy forward when it recovers eventually
- Fall in productivity is not alarming if it is mainly due to difficulty in winning contracts / delay in investment / labour hoarding during a slump  $\Rightarrow$  can be resolved on its own once the economy recovers

**(c) Explain what is meant by “we need strong productivity in the long term to raise living standards and to maintain our competitiveness”. [4]**

- $\uparrow$ productivity  $\Rightarrow \uparrow$ LRAS  $\Rightarrow$  sustained non-inflationary growth ( $\uparrow$ NY)  $\Rightarrow$  higher SOL (material or non-material elaborate)
- $\uparrow$ productivity  $\Rightarrow \downarrow$ COP or greater value-addedness  $\Rightarrow$  more competitive export or more competitive FDI destination  $\Rightarrow$  maintain international competitiveness

**(d) (i) Identify the evidence that suggests Britain’s economic slump in 2008-2009 could turn out to be a severe one. [3]**

- Figure 2: weak real wage growth – negative growth in Q3 2008 & Q1 2009
- Figure 3: substantial fall in GDP across Eurozone, and in US
- Extract 2: banks struggling to finance new projects due to financial crisis

**(d) (ii) Using AD/AS analysis, explain how the above evidence eventually led to a severe slump in the UK. [5]**

- Figure 2: weak real wage growth – negative growth in Q3 2008 & Q1 2009  $\Rightarrow$  fall in purchasing power  $\Rightarrow$  fall in C

- Figure 3: substantial fall in GDP across Eurozone, UK and US => fall in foreign income => fall in X + worsened outlook => fall in C & I
- Extract 2: banks struggling to finance new projects due to financial crisis => fall in I
- Diagram: fall in AD=> fall in NY

**(d) (iii) In view of the reasons above, discuss alternative policies the government might consider adopting to stimulate the British economy. [8]**

#### **Exp. FP**

- increase G: giving transfers to households to increase their purchasing power=>increase C, building physical & digital infrastructure also helps to encourage I
- reduce T: PIT rebate => higher disposable income => higher C, CIT rebate => higher after-tax profit => greater incentive & ability to invest

#### Limitations:

- time lags
- fiscal position
- poor outlook => C & I may not increase, k also may be small due to low MPC

#### **Policies to promote lending**

- QE: govt buys up bad debts from banks to give them more cash to lend out to new projects => increase I
- Risk-sharing b/w govt and banks to reduce banks' risk of lending => encourage them to lend => increase I
- Lower i/r not accepted since qn asks for "alternative" policies

#### Limitations:

- Poor outlook may still prevent banks from lending
- Fiscal position

#### **ERP**

- Weaken British Pound => cheaper exports in foreign currency, more expensive imports in Pound => increase NX if MLC satisfied

#### Limitations:

- May not be sufficient to offset the fall in DD for Xs
- J curve effect => worsen slump in short run

#### **SSP**

- Invest in infrastructure & skills => encourage more I
- Productivity might have really fallen => fall in LRAS => SSP to increase LRAS to enable actual growth without inflation

L3	Developed discussion on at least 2 alternative policies that the UK government might consider adopting to stimulate the British economy.	7-8
L2	Undeveloped discussion.	4-6
L1	Smattering of valid points.	1-3