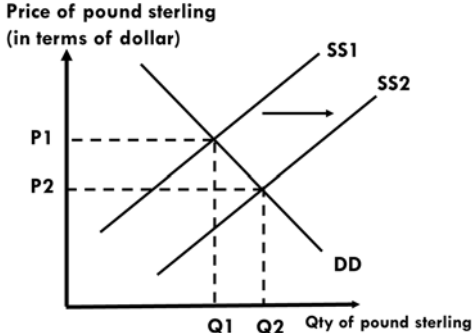
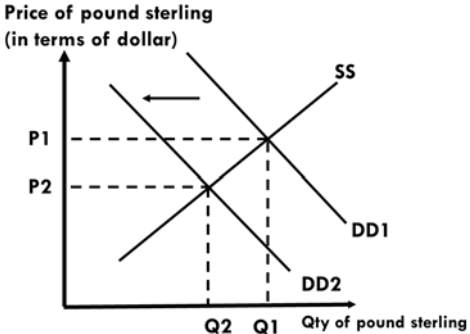


(a)	With reference to Table 4, compare the changes in GDP between Germany and the UK from 2015 to 2017.	[2]
<p>Similarity: GDP of both Germany and the UK increased from 2015 to 2017.</p> <p>Difference: However, Germany's GDP was increasing at an increasing rate, while the UK's GDP was increasing at a decreasing rate.</p>		
(b)	(i) Using a diagram, explain why the pound sterling fell in value after UK had voted to break out of the European Union.	[2]
<p>As mentioned in Extract 4, breaking out of the European Union was a "lurch into the unknown", which could give rise to loss in investors' confidence in the economy.</p> <p>Explain impact on SS of pound sterling in forex market: This would cause capital outflow from the UK, leading to an increase in supply of pounds in the foreign exchange market, hence reducing the external value of the pound sterling.</p> <p>OR Explain impact on DD for pound sterling in forex market: This would cause a fall in capital inflow into the UK, leading to a decrease in demand for pounds in the foreign exchange market, hence reducing the external value of the pound sterling.</p> <div style="display: flex; justify-content: space-around;">   </div>		
(b)	(ii) Explain whether the depreciated pound sterling would lead to a higher cost of living and standard of living in the UK.	[6]
<p>Depreciated pound sterling → fall in price of exports in F.C but increase in price of imports in D.C</p> <p><u>Impact on cost of living</u> If consumers consume a large quantity of imports, the increased price of final imported goods and services will mean that cost of living will increase.</p> <p>OR If UK firms import significant amount of raw materials from overseas, this will cause imported inflation and hence, increase their unit cost of producing domestic final</p>		

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goods, hence, causing SRAS to fall, leading to increases in GPL. Hence, cost of living increases.

Impact on material SOL

Assuming marshall-lerner condition holds ($PED_x + PED_m > 1$), net exports will increase as seen from “boosted exports orders for manufacturing”(Ext 6) → assuming there is spare capacity in the economy → increase AD will result in increase in real output → national income increases by a multiplied amount → increase in quantity of goods and services consumed → increase material standard of living

Explain “whether”: Comment on the extent of change

Material SOL may have worsened instead if the rise in general price level is faster than the increase in national income.

(c)	Explain a likely advantage to the foreign firms for locating their businesses in Ireland.
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[2]

Cost advantages

Locating businesses in Ireland will enable foreign firms to tap into the large EU market and sell to a larger market as inferred from “jumping off point for their European ambitions” (Ext 5). Such increase in market size in turn enable it to produce larger quantity, reaping economies of scale, hence enjoying lower average cost and higher profit, ceteris paribus.

Or

Access to good “technological infrastructure” and “leading services” (ext 5) can enable foreign firms to gain greater productivity if these translate to greater output produced per hour with lesser disruptions to internet connection etc, hence enjoying lower average cost and higher profit, ceteris paribus.

Revenue advantages

Being able to sell to a larger market means that foreign firms will be able to gain larger increases in demand for their goods and services, resulting in increases in total revenue and hence profits, ceteris paribus.

(d)	In light of the issues faced by the UK, as mentioned in Extract 3, evaluate the Bank of England’s decision to cut interest rate.
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[8]

Issues faced by UK: Extract 3: “Inflation is surging, consumer spending is slowing, productivity remains mired in pre-crisis growth levels, and uncertainty reigns supreme”

Explain how decrease in interest rate works

Decreases in interest rate → decrease cost of borrowing → more firms will be willing to invest → Investment level increases

The fall in the cost of borrowing would also result in an increase in consumption expenditure on big ticket items as consumers would have the ability to purchase items on credit.

Decrease i/r: Ability to address the various issues faced by UK

(Students should address at least 2 problems mentioned below.)

1. “Slowing consumer spending”

The lowered cost of borrowing will therefore help to address the ‘slowing consumer spending’ and hence help to contribute to economic growth.

The increase in both consumption and investment expenditure would result in an increase in UK’s aggregate demand as $AD = C_d + I + G + X \rightarrow$ shortage created \rightarrow firms run down inventories \rightarrow upward pressure on GPL \rightarrow incentive for firms to \uparrow output to meet demand \rightarrow real output in economy has increased, leading to actual growth.

2. “Inflation is surging”

The decrease in interest rate may cause hot money outflows, hence, causing pound to depreciate further. This would worsen inflation rates as explained in part bii. However, this maybe a temporary impact as pound may strengthen after the situation on Brexit has stabilised.

3. “Uncertainty reigns supreme”

However, given that ‘uncertainty reigns’ \rightarrow the extent of increase in C_d and I will be smaller as consumers are more likely to withhold consumption given uncertainty in their employment and firms are also likely to withhold investment levels given the uncertainty in UK’s economic outlook after Brexit \rightarrow policy will be ineffective in raising economic growth, if this is the intent of the UK govt.

4. “Productivity remains mired in pre-crisis levels”

Also, whether the decrease in interest rates will help to increase productivity in UK depends on the type of investment that the firms will undertake given the cheaper cost of borrowing. Given that it is rather incidental; the effectiveness of the policy is likely to be very low.

Conclusion

[evaluate UK’s decision] UK’s decision to cut interest rate is ineffective given that it is less likely to address any of the above problems. With uncertainty as the biggest problem, therefore, increases in AD is likely to be low.

More importantly, weak productivity is likely to be a main concern and area for the UK govt to focus on as UK leaves the EU. It needs to increase its competitiveness in order to prevent greater loss of FDIs out of UK as a result of foreign firms that used to locate in UK to have access to the larger EU market.

[suggest alternative policies] This can also help to reduce the uncertainty on UK’s future economic outlook. Therefore, the UK govt should start looking at implementing ss-side policies instead.

Level	Knowledge, Application, Understanding and Analysis	Marks
L2	For a well-explained answer on decreasing interest rate to address at least 2 macroeconomic problems faced by UK.	4-6

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L1	For a limited explanation (lacking in economic linkages and analysis) on decreasing interest rate to address the macroeconomic problems faced by UK.	1-3
	Evaluation	
E1	For an evaluation based on economic analysis and case materials arriving at a judgement on UK's decision to cut interest rate.	1-2

(e)	With reference to the data where appropriate, assess whether on balance, the benefits of Brexit outweigh the costs for UK and the remaining EU member countries.	[10]
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Introduction:
The decision to leave the EU will give rise to both benefits and costs to the UK as well as the remaining EU member countries. However, whether the benefits outweigh the costs for the UK and the remaining EU member countries depends on a few factors.

(Note: Students should at least discuss 1 cost and 1 benefit for UK and EU respectively.)

Development 1: Explain the impacts of Brexit on UK

Benefits of Brexit to UK

1. Impact on export revenue of the economies

One major and immediate impact on the UK after the Brexit vote was a depreciation of the pound sterling against the dollar (Extract 4), which was explained in (b)(i). This will lead to an increase in price of exports for the UK in foreign currency, as well as a decrease in price of imports in pound sterling. Assuming the Marshall-Lerner condition holds, where $(PED_x + PED_m) > 1$, this leads to an increase in $(X-M)$ and hence AD. There is an increase in real output and hence actual growth in the UK. As mentioned in (b)(ii), this may lead to an increase in material SOL.

2. Impact on govt's contribution to the EU budget

Given that the UK is a net contributor to the EU budget, contributing up to £11.3 billion in 2013 (Extract 4), Brexit would mean that the UK government doesn't need to contribute to the EU budget in future and could use the funds to stimulate their own economy. For example, the government could now use the funds to build infrastructure in the UK, giving rise to an injection via increased G in the UK economy. This will lead to an increase in AD, and hence actual growth in the UK economy and improvement in material SOL due to rising incomes and greater purchasing power and access to goods and services. Depending on which area the government spends on, for e.g. if they spend on education and healthcare, there could also be improvement in non-material SOL.

Costs of Brexit to UK

1. Impact on migration and the labour force

One of the main arguments for those in favour of Brexit was with regard to the migration of labour from other EU countries. Moving forward, if the UK were to cap immigration (Extract 7), there could be some consequences on their economy. Firstly, with these migrants now returning to their own countries, the UK's labour force shrinks and this could give rise to a fall in productive capacity, illustrated by a fall in the AS curve. This results in a fall in future material SOL as inflationary pressures may persist with any increases in AD given a lower AS curve.

EV: However, this cap on immigration could also bring about some benefits to the UK. With lesser migrants in their country, the quality of life of the remaining citizens (and hence non-material SOL) may improve since issues like congestion will be reduced given the smaller population size.

2. Impact on level of FDI

Given that the EU single market was a major factor in attracting FDI into the UK (Extract 7), now that the UK is preparing to leave the EU, they would no longer have access to the single market as before. As mentioned in Extract 7, FDI may be diverted to other EU countries now, instead of the UK. The UK faces a fall in FDI and this leads to a fall in AD and hence negative growth. The fall in FDI could also lead to a fall in the UK's AS curve as well, if the rate of increase in FDI does not outweigh the rate of depreciation of capital. This causes a fall in the UK's productive capacity in the LR.

Development 2: Impacts of Brexit to EU members

Benefits of Brexit to EU members

1. Impact on level of FDI

Given that the UK is no longer seen as a viable destination for FDI (Extract 7), there could be diversion of FDI to the remaining EU member countries. This will cause an increase in AD in the SR and AS in the LR for these countries, causing actual and potential growth.

Costs of Brexit to EU members

1. Impact on export revenue of the economies

As it is predicted that there could be a possible reintroduction of tariffs (Extract 7), where the UK imposes tariffs on goods from the remaining EU countries, the UK will import less from the other EU member countries as compared to before when the UK was still part of the EU and they enjoyed free trade. Given a fall in import expenditure by the UK for these countries goods, they will then experience a fall in export revenue and hence a fall in AD. This causes negative economic growth and rising unemployment → fall in material SOL.

EV: However, the extent of fall in X and AD for the remaining EU members depends on how close they were to the UK as trading partners. For instance, Extract 7 suggests that Ireland could be more severely affected compared to Germany, especially because Germany has diversified its trading partners and has "many other markets" for its auto and manufacturing sector. Hence, even with the lack of free trade with the UK, Germany can still generate export revenue through the sale

of exports to other countries. That said, Ireland has actually been able to enjoy higher growth rates than the UK and the EU as a whole from 2015 to 2017 (Table 4), so it could mean that they have been able to generate growth through other means apart from export revenue to the UK.

2. *Impact on govt's contribution to the EU budget*

Since the EU's biggest contributor to its budget (i.e. the UK) has voted to leave the EU, the remaining EU member countries would now have to "fill in some of the shortfall from a lack of its contributions" (Extract 7). This is estimated to be up to 19.4 billion euros in total, with a large amount contributed by Germany of about 2.5 billion euros. This would mean that the governments of those countries would incur an opportunity cost in terms of the loss in benefits from not spending that sum of money on areas such as healthcare or education in their own economies. The larger their contribution is to the EU budget (e.g. for countries like Germany), the larger the opportunity cost incurred.

3. *Impact on migration and the labour force*

If the UK were to cap migration, migrants from other EU countries who used to be in the UK will now have to return back to their countries. As mentioned in Extract 7, countries in eastern Europe (e.g. Poland, Romania) will suffer the most as they have the most number of citizens in the UK. With the large numbers of migrants returning home, assuming if they are low-skilled workers, this will cause the supply of low-skilled labour in those countries will increase, driving down wages in their labour market. There could also be large scale unemployment which could bring about increased social problems and increased burden on government budget should these governments have to provide unemployment benefits for these returned unemployed migrants.

EV: However, migrant workers maybe also be of higher skillsets. If so, they can contribute to a more productive workforce and hence increase productive capacity (rightward shift of AS) → potential growth.

Conclusion:

[Answer the question] Evaluate whether benefits outweigh the costs:

For the UK, whether or not the benefits outweigh the costs would depend on whether the government is able to put in place appropriate policies to deal with the potential loss in FDI as well as the fall in productive capacity. For instance, if the UK is able to develop the right infrastructure to attract FDI (e.g. like Ireland, in Extract 5), the fall in FDI may not be so significant despite them not being a part of a large EU single market. In addition, should the government be able to adopt appropriate supply-side policies to increase productivity in the economy, in spite of the cap on immigration which would lead to a fall in the quantity of labour, the quality of both labour and capital can more than make up for it and hence still allow for an increase in the productive capacity of the UK's economy in the LR. This is especially possible since the UK govt's contribution to the EU budget can now be reallocated for such a purpose.

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For the remaining EU members, whether or not the benefits outweigh the costs depend on the closeness they are to the UK as trading partners and whether they are able to diversify their trade to depend on other economies now that free trade with the UK is no longer possible after their departure. Also, while the UK has now left the EU, making the remaining member countries more attractive to FDI since they are still part of the single market offered by the EU, the extent to which they can benefit from increased FDI also depends very much on their own attractiveness as a destination for FDI. For e.g., Ireland is an attractive destination for FDI and would probably be able to attract much of the existing FDI in the UK over given their “natural advantages” (Extract 5).

Level	Knowledge, Application, Understanding and Analysis	Marks
L2	Explanation of the benefits and costs of Brexit on the UK as well as on the remaining EU member countries with thorough economic analysis, making explicit links to macroeconomic goals as well as SOL	5-7
L1	Explanation of the benefits and/or costs of Brexit on the UK and/or the remaining EU member countries, which may or may not include clear reference to the macroeconomic goals or SOL	1-4
	Up to 3 additional marks for evaluation	
E2	Application of relevant economic concepts to make a judgment on whether the benefits of Brexit outweigh the costs for both the UK as well as the remaining EU member countries	2-3
E1	Unexplained judgment on whether the benefits outweigh the costs for the UK and/or the remaining EU member countries	1