Application and understanding

Candidate 1

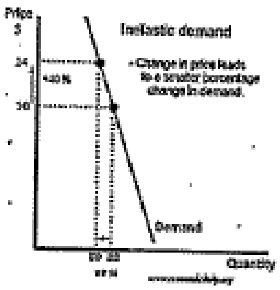
Topic – to what extent will the rising costs of energy impact the UK economy?

Application and understanding

Impact on Individuals

Price elasticity of demand (PED) measures the responsiveness of demand after a change in price. Energy is a necessity for every household and individual. This makes energy price inelastic. Inelastic demand means, when there is an increase in the price of a product, there is minimal change to the demand. Price elasticity is calculated using the following equation:

$$\text{Price Elasticity of Demand (PED)} = \frac{\text{\% change in Q.D.}}{\text{\% change in Price}}$$



[3][4]Due to energy's inelastic nature, increasing the cost of energy means each household will have a significant decrease in their spending power.

The opportunity cost is the loss of the next best alternative. In this case, as individuals are spending a larger sum of their income on energy, they are losing

[3] https://www.economicshelp.org/microessays/equilibrium/price-elasticity-demand/ Appendix 9
[4] https://www.economicshelp.org/microessays/equilibrium/price-elasticity-demand/ Appendix 9

the opportunity to spend their money elsewhere on goods and services such as food or getting a haircut. Decreasing the standard of living for individuals across the UK.

In addition, other individuals, despite energy being price inelastic, may need to seriously reduce their use of energy, as they simply cannot afford the cost of living with the additional increase in energy bills. This immensely reduces individuals across the UK's standard of living as they may not be able to use electronics such as a TV for entertainment or heat their house during cold weather.

Impact on Firms

Due to the increase in price in energy, UK firms' unit cost of production will increase. As a firm they will either need to pass on these additional costs onto the consumer or absorb these costs. If a firm decides to absorb these costs, their profits will decrease. However, firms which decide to absorb costs, may be a cheaper alternative to the consumer compared to firms that have passed prices onto the consumer. This may increase the demand of said firms produce so total revenue may increase, as long as there is an available supply. In other terms, the firms' profit per product may decrease but if the quantity of produce sold is greater, then the total revenue will increase and the firm may be able to expand, positively impacting these firms.

On The other hand, firms which decide to pass on these costs onto the consumer begin a cost-push inflation. This means, the increase in price for consumers (inflation) is caused by firms higher cost of production driving them to increase the prices. Firms which have increased their prices for a product may see a fall in demand, this could be due to consumers choosing cheaper alternatives or simply not being able to afford the increase in prices. A decrease in demand means that the firms' total revenue will decrease and therefore profits, negatively impacting these firms.

Impact on the Government

High rates of Employment is one the main government aims, however, an increase in the cost of production for firms may lead to a reduction in their workforce and therefore an increase in unemployment. Higher rates of unemployment means there will be an increase in the governments transfer payments such as benefits, this causes the loss of the potential for governments to spend money elsewhere, such as building a new hospital or school. A decrease in employment will also decrease the government's total revenue as there will be a significant decrease in income tax. Since there is a greater level of unemployment, there will be less spending on goods and services from these individuals so revenue from indirect tax - such as VAT- will also decrease.

Candidate 2

Topic – effect of increased interest rates on the UK economic agents

Application and Understanding

Effect of consumers:

When interest rates rise, consumers will be motivated to save a larger amount of their income because they will be able to get more money through interest therefore, they will decrease their spending on goods so demand will fall. Consumers will also be motivated to borrow less as they will have to pay more money back through interest so consumers may have less debt and as a result, they may have more disposable income. Consumers may also have to pay more in mortgage payments and so may have less disposable income and so may spend less. Consumers may also have reduced income due to becoming unemployed which may happen due to firms having reduced revenue and so they may not be able to afford to hire as many workers.

Effect on firms:

When interest rates increase, firms will export less as the value of the pound would increase which would cause consumers and firms outside of the UK to purchase less UK exports, as they would be more expensive for them as they get less pounds for their currency, so demand will fall for UK firms. Additionally, UK firms could experience more competition from multinationals who begin to import more of their goods to the UK as there is more demand for imports due to consumers and firms in the UK being able to buy more of other currencies with their pounds and so imports would be cheaper and so demand for goods sold by UK firms would be reduced. Firms would also have reduced demand for their goods as consumers are saving more and so are spending less of their income on goods which means that firms may have reduced revenue. Firms may also have increased productivity due to increased unemployment as firms will have a larger pool of workers to choose from so, they can hire the most skilled workers.

Effect on government:

The government may have reduced revenue due to firms having less revenue and paying less corporation tax as a result. They may also have reduced revenue from indirect taxes such as VAT as consumers are spending less due to them saving more as a result of increased interest rates. They may also have reduced revenue from income tax due to a higher rate of unemployment. Higher unemployment may also cause they government to have to increase spending on welfare payments which will result in the government having less to spend on things such as healthcare and infrastructure. National debt may increase as the government's interest payments will increase as interest rates are higher and as a result the government may have to increase taxes.

Candidate 3

Topic – what impacts could a universal basic income have on the UK economy?

Application of Knowledge and Understanding

Individuals

A standardised basic income could mean for individuals, that they will see an increase in their disposable income/spending power. Disposable income is the income left to an individual once taxes have been deducted. In addition to this, many will also see an increase in their standard of living. Standard of living is a measure of material welfare and an increase in this will be beneficial in that individuals live a better quality of life.

Individuals who were previously unemployed and on a lesser income/ standard of living may become used to a higher quality of life and seek employment for a higher wage return on their labour. This benefits the individual in that they become happier and more satisfied, but also benefits the government in that the unemployment rate will fall.

Governments

Secondly, a universal basic income may encourage a multiplier effect regionally or nationally. The multiplier effect is where an increase in government spending sees a greater increase in National Income. When the government spending concerned is UBI, there could be a greater increase in National Income. This could be beneficial as total GDP could increase and the unemployment rate could fall due to the increase in demand.

A universal basic income could also mean the economy facing a fiscal drag. For those paying the highest tax bracket, they could see a further increase in the tax they are required to pay to the government. This is because the huge increase in government spending would have to be partially covered by tax revenue. This could be disadvantageous to the individual and to the government, as the individual could become frustrated at their reduction in spending power, they may become demotivated to work and so the government might see an increase in the unemployment rate or tax evasion which could further worsen the balance of payments.

Further, the government may use basic income to lessen the extremities of pre-existing market failures such as income inequality. This is because the tax revenue of the wealthiest will be equally and fairly distributed to everyone without a means test, somewhat lessening the gap in living standards between richest and poorest and so partially solving the market failure of income inequality.

Government spending will have to increase significantly on transfer payments if they were to implement a basic income, this means that these funds cannot be spend elsewhere due to scarcity and opportunity cost. Because the government is spending a huge sum on implementing basic income, it now cannot spend those funds on education or healthcare and so they are foregoing the benefits that they would have seen had the funds been injected into their departments.

<u>Firms</u>

For firms, demand for products will increase as individuals see an increase in their spending power. This is because one of the determinants for demand is the income of the buyer so that when the buyer's income increases, they now may purchase more expensive goods, or more of the same goods. For the firm this will mean as their demand increases, they may require more staff to cope with the demand, potentially increasing their costs of production through having to pay wage and training.