A* Chains of reasoning - Analysis and Evaluation - Applicable to most essays

Definitions - Learn these as they come up in the chains of reasoning below!

Quantitative Easing (QE) - When the central bank electronically generates money and uses it to buy bonds and other securities from high-street banks. This gives high-street banks more cash to lend more to businesses and consumers

Crowding in - Government spending encourages private investment into certain regions and industries

Animal spirits - The confidence that consumers and investors (we tend to say animal spirits for investors and consumer confidence for consumers) have in the future-prospects of the economy. Low animal spirits = Less investments

MPC - Marginal Propensity to Consume - The proportion of an increase in income that a person or household is likely to spend on consumption. The larger the MPC = The larger the multiplier effect

Human capital - Knowledge and skills required for a job

TNCs - Transnational corporations (same as an MNC) - Companies that operate globally and often have global supply chains such as Nike

Incumbent firm - A firm that has been in an industry for a long period of time, before new entrants join it. E.g. Samsung in the smartphone industry before Huawei joined.

Dumping - When a country deliberately sells goods in another country at a much lower price than the market price in order to gain large market share over the domestic producers

X-Inefficiency - When a firm operates above its Average Cost curve due to managerial slack

CMA - The competitions and Markets Authority - The organisation that intervenes in markets to ensure companies are acting in the consumer's interest

Sunk Costs - Costs of starting a business that you cannot get back e.g. advertising

Claim	Analysis	Evaluation
“Decreasing income tax will result in more consumption and an increase in Real GDP”	Tax rates decreasing -> increased disposable income -> increased consumption -> increase AD (as consumption makes up 60% of AD) -> increases Real GDP	1) Increase in consumption -> increase in AD -> demand-pull inflation -> exports more expensive -> less exports -> (x-m) decreases -> Real GDP falls 2) How strong is consumer confidence? 3) Time lag - May take a while for consumers to adjust their spending habits 4) Less government revenue -> less government spending -> GDP falls 5) What are the interest rates? If they are high then the MPS will also be high - people will be saving not consuming so GDP will not increase. (This can be interchanged for tax if the question asks about the impact of interest rates on consumption)
“Higher levels of investment will lead to an increase in Real GDP”	Fall in interest rates -> Cost of borrowing decreases = opportunity cost of borrowing decreases -> Investment increases -> AD increases as investment makes up 15% of AD -> Real GDp increase	1) What if animal spirits* are low? 2) How large is the fall in interest rates? 3) What if companies don’t have the money to invest (maybe poor revenues due to recession or they’re investing in RnD)
“‘If Government spending increases, Real GDP increases”	Government spending -> crowding in* -> positive multiplier effect -> AD increases as Gov spending is 25% of AD -> Real GDP increase	1) Ricardian equivalence theory - Government spending will not boost gdp because consumers will reduce their consumption as they know the government will raise tax rates in the future (This is a very impressive theory to mention) 2) What if government debt increases? Gov debt is almost 100% of GDP and servicing the interest on these debts cost the UK billions. Therefore, more gov spending could lead to higher tax rates in the future or spend less on the economy as the government now needs to spend more servicing debt interest 3) Crowding out* - government spending may in-fact discourage private

		investment, leading to a fall in AD and Real GDP
"If (X-M) increases, Real GDP increases"	Increase in exports -> increase in export revenue as exports are an injection into the circular flow of income > AD increases as (x-m) makes up 1% of AD -> GDP increases (as seen on AD diagram)	1) What else is happening in the economy, what is the tax rate, government spending, inflation? could these offset the growth caused by the trade surplus? 2) How long will the surplus last, could this only be short term? E.g. Vietnam exported technologies to the US during the China-US trade war but this growth was only temporary 3) Time lag.
"QE leads to economic growth"	Kaa 1) QE* -> More cash for highstreet banks = more loans to companies and consumers -> more Consumption and Investment -> AD increases -> GDP increases Kaa 2) QE -> supply of money increases -> value of money decreases -> Weak pound = imports expensive, exports cheap -> exports cheap = international competitiveness increases -> exports increase -> (x-m) increases -> AD increases -> GDP increases (These chains-of-reasoning show you understand QE also effects the UK on a global scale)	1) Could be inflationary if it leads to demand-pull inflation, this can lead to an increase in poverty and inequality as savings decrease and the cost of living increases. Consequently, the government may have to spend more on benefits, leading to an increase in the government debt. 2) Depends on animal spirits* and consumer confidence - there may be no demand for loans if investors fear recessions or the MPC* of consumers is low 3) Increasing the supply of money will lead to a decrease in the value of money (as seen on a dollar supply and demand graph) this means that imports will become more expensive. The UK imports manufacturing goods such as steel because we do not produce these on a large scale. Therefore, increasing the supply of money will make these imports more expensive, causing cost-push inflation, making our exports less internationally competitive. This means demand for our exports will decrease and export revenues will fall leading to a fall in AD and therefore a fall in Real GDP. (Very impressive evaluation that applies to questions on appreciations and depreciations)
"Increasing the National Minimum Wage (NMW) will reduce profits for firms"	Rising costs such an increase in the NMW normally raise costs of production. Wages are usually defined as variable costs meaning that an increase in wages will shift both the average and variable cost curves leading to a fall in	1) Wage efficiency theory (Very impressive to use). Higher wages can incentivise workers to become more efficient because the opportunity cost of them losing their job is now greater than it previously was. The firm can now fire some of their workers as they need less workers than previously to maintain the same output, this will reduce costs, rather

	profit (seen on a costs and revenues year 2 diagram).	than increase them, leading to an increase in profit. 2) How large is the increase in the minimum wage? If only by e.g. 50p this may not significantly change the firm's profits 3) Note that if the question says National Living Wage, this is for over 21 year olds. An Evaluation for this is that businesses could hire younger workers meaning their costs would not increase. In-fact, their competitors may continue hiring over 21 year olds and go out of business, leaving this firm with a dominant market position and the ability to make more profit than prior to the change in the national living wage.
"Increasing spending on education and infrastructure will cause supply-side growth and profits for firms"	Macro) Government spending on education -> higher levels of human capital* -> more efficient workforce -> increased quality of labour -> LRAS shifts outwards Micro) Government spending on infrastructure -> increases efficiency and productivity, e.g. Elizabeth line allows commuters access to WI-FI on the way to work -> also grants firms access to external economies of scale -> costs decrease -> Profits increase	Macro 1) Brain drain - Skilled workers will leave the economy and go to other countries where they can progress their careers further than their native country. E.g. Poland spends money on education and training yet many Poles leave the country afterwards to work in the West where salaries are higher. Macro 2) Time lag - Certain professions like becoming a heart surgeon can take up to 12 years of training. This means that the increase in Aggregate Supply would only be seen in the future. Micro 1) Could experience diseconomies of scale which raise costs of production and decrease profits for firms. Micro 2) Government spending on infrastructure could attract large TNC's* from abroad that monopolise the industry and kick the incumbent* firms out meaning that their profits actually decrease.
"Imposing a tariff will increase real GDP"	Macro 1) A tariff forces domestic consumers to pay more for imports. This raises revenues for the government which they can spend on education and infrastructure boosting LRAS. Macro 2) Moreover, imports, which are a leakage from the circular flow of income, will decrease, leading to an increase in AD and real	Macro 1) Tariffs could start a trade war. The China-US trade war lost $9.1 billion globally. The country could retaliate and impose a tariff on our exports, leading to a huge decline in export revenues and a fall in AD and Real GDP. Macro 2) The government revenue raised may not be spent equitably or efficiently and may be spent on servicing debts - The UK currently spends £100bn servicing debt interest yearly.

	GDP due to the increase in (X-M). Micro) A tariff means that consumers will no longer import and will turn to domestic producers. This means that demand for domestic firms will increase.g. Biden's 25% tariff on Chinese electric vehicles caused demand for Tesla to increase. Increased demand will cause AR and MR to shift, leading to higher profits. The tariff also prevents dumping* which means that the domestic firms can retain their profits for a long period of time.	Micro) Domestic firms may become inefficient as they no longer face international competition. This could lead to x-inefficiency* and costs may start to rise, causing a decrease in profits.
"The CMA can break up monopolies by subsidising new entrants"	CMA* grants a subsidy to a new entrant such as a new supermarket. The new supermarket can use the grant to reduce its costs of production and undercut the incumbent firms to gain some market share. They could then use the profit from the increased demand (shown by a shift in AR and MR) to invest in R&D*. This could lead to innovations and higher quality products meaning that they could gain an even large share of the market as customers become loyal.	1) Incumbent firms like Tesco who have huge economies of scale can undercut the new firms by charging extremely low prices, possibly even predatory pricing* in order to kick the new entrants out of the industry. 2) The incumbent firms could also invest in R&D and it is likely that they have more money to do so, leading to better quality products and services that the new entrants cannot deal with 3) The subsidy would have to be enormous to allow a new entrant into certain industries like the supermarket industry where sunk costs* are high.