

AS ECONOMICS

Paper 2 The National Economy in a Global Context

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DO NOT WRITE ANY ANSWERS IN THIS INSERT. YOU MUST ANSWER THE QUESTIONS IN THE ANSWER BOOKLET PROVIDED.

CONTEXT 1: ECONOMIC GROWTH

Questions 21 to 26

- **Extract A:** Real GDP growth, annual percentage change, various economies, 2015–2019
- **Extract B:** The global economy goes into recession
- **Extract C:** Can we look forward to a decade of prosperity and opportunity?

CONTEXT 2: GOVERNMENT SPENDING AND TAXATION

Questions 27 to 32

- **Extract D:** Composition of UK government spending, 1997–98 to 2018–19
- **Extract E:** Government spending to the rescue
- **Extract F:** How should the money be spent?

Context 1

Total for this context: 50 marks

ECONOMIC GROWTH**Extract A: Real GDP growth, annual percentage change, various economies, 2015–2019**

Year	UK (%)	Germany (%)	US (%)	China (%)	World (%)
2015	2.4	1.7	2.9	6.9	3.5
2016	1.9	2.2	1.6	6.8	3.4
2017	1.9	2.5	2.4	6.9	3.9
2018	1.4	1.5	2.9	6.7	3.6
2019	1.4	0.6	2.3	6.1	2.9

Source: International Monetary Fund, World Economic Outlook, April 2020

Extract B: The global economy goes into recession

Even before the world economy was hit by the pandemic in 2020, the greatest economic shock for centuries, there were signs that economies were in the midst of a global slowdown. This had made price stability easier to achieve but growth rates were disappointing. 1

Output had been adversely affected by the rising tensions in global trade. The US had placed import taxes on various goods from a number of countries including China, Canada and those in the EU, leading to a fall in exports from those countries. In addition, structural changes to industries, such as the movement away from petrol and diesel cars and the rise of artificial intelligence technology had resulted in some job losses. In the UK, political uncertainty surrounding Brexit had been cited as a major cause of disappointing growth and low levels of investment. These factors, amongst others, damaged business confidence, and many firms were reluctant to invest in new capacity. 5 10

Yet all this seems insignificant compared with what was to follow. When consumption abruptly fell and production in some industries completely stopped, economies contracted severely. For example, in the three months to May 2020, UK output shrank by a staggering 19.1% compared to the previous three months. When a report by the International Monetary Fund in June 2020 forecast that annual world output would contract by 4.9% during 2020, by 10.2% in the UK and the Euro area, and 8% in the US, people began to wonder if the recession would ever end. According to the report, even China was expected to have real GDP growth of only 1%. 15

Source: News reports, July 2020

Extract C: Can we look forward to a decade of prosperity and opportunity?

Faced with such uncertainty and gloomy expectations, it was almost impossible to remember the time when the Prime Minister, Boris Johnson, had promised to make the 2020s a “decade of prosperity and opportunity”. If this is to be achieved, it will be essential to find ways to boost both short-run and long-run growth, but firstly confidence and optimism must be restored. 1

In March 2020, the Bank of England’s Monetary Policy Committee announced a second emergency cut in bank rate to 0.1%. Designed to reduce the costs of existing and new borrowing, it was hoped that this would maintain spending in the economy. Monetary policy was also used to increase the supply of money and credit. The Chancellor of the Exchequer, Rishi Sunak, also announced further unprecedented increases in government spending and reductions in various taxes. On a global level, it was hoped that exports would slowly start to recover. The measures that have been taken and the anticipated revival of the world economy should support demand-side growth. 5 10

What about supply-side growth? The Chancellor announced a range of supply-side plans. For example, more than £600 billion is to be spent on infrastructure such as roads, rail and broadband by the middle of 2025; and an extra £900 million on research into nuclear fusion, space and electric vehicles. An increase in the funds available for education and training should help to improve factor mobility and ensure the labour force has the skills the economy needs. The current, low rates of direct taxation help to create incentives to work, save and invest, but in the future, taxes may have to rise to pay for the increase in government spending. 15

Source: News reports, July 2020

Turn over for Context 1 questions

Turn over ►

Context 1: – Questions 21 to 26

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 Define 'price stability' **Extract B** (line 3). **[3 marks]**
- | | |
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 If UK GDP was equal to £2073 billion in 2017, use **Extract A** to calculate, to the **nearest billion**, the value of UK GDP in 2018. **[4 marks]**
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 Use **Extract A** to identify **two** significant points of comparison between the growth rates of the UK and Germany over the period shown. **[4 marks]**
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Extract C (lines 16–17) states: 'An increase in the funds available for education and training should help to improve factor mobility'.

Draw an AD/AS diagram to show the long-run impact of improved factor mobility on the price level and national income. **[4 marks]**
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Extract B (line 2) states: '...there were signs that economies were in the midst of a global slowdown'.

Explain how a global slowdown can affect employment in the UK. **[10 marks]**
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| 2 | 6 |
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Extract C (lines 2–4) states: '...the Prime Minister, Boris Johnson, had promised to make the 2020s a “decade of prosperity and opportunity”. If this is to be achieved, it will be essential to find ways to boost both short-run and long-run growth'.

Use the extracts and your knowledge of economics to evaluate different policies that can be used to increase the long-run rate of growth of the UK economy. **[25 marks]**

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Turn over for Context 2

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Context 2

Total for this context: 50 marks

GOVERNMENT SPENDING AND TAXATION

Extract D: Composition of UK government spending, 1997–98 to 2018–19

Year	Social security (%)		Health (%)	Education (%)	Debt interest (%)	Other (%)
	Old-age related (%)	Other social security (%)				
1997–98	14	23	14	12	9	27
2007–08	15	19	18	14	5	29
2018–19	17	18	20	13	5	27

Notes: Examples of 'old-age related' spending include pensions and personal care; examples of 'other social security' spending include sickness and housing benefits. Figures may not add up to 100% due to rounding.

Source: Resolution Foundation: The Shape of Things to Come, November 2019

Extract E: Government spending to the rescue

In 2019, a report by an independent think tank, the Resolution Foundation, concluded that a decade of austerity in public finances had led to an 'unprecedented pause' in government spending growth between 2010–11 and 2018–19. Consequently, with services such as the health service, social care and the police force facing funding challenges, the report suggested that significant increases in spending would be required to help improve the wellbeing of the UK population. Indeed, whilst government spending as a proportion of GDP was 46.3% in 2009–10, it has been decreasing since, and in 2018–19 stood at 39.3% of GDP.

However, no one could have predicted the size of the increase in government spending which was required to rescue the UK economy from the pandemic which caused the largest economic shock in its history. By July 2020, emergency spending had surged by £190 billion. As a result, it was predicted that spending as a proportion of GDP would exceed 50% for the financial year, higher than the peak seen during the financial crisis. The rise in spending, at a time when tax revenues were falling, led to a very large increase in the budget deficit. It is expected that government borrowing will reach £350 billion for the year 2020–21.

Government spending acts as an injection into the circular flow of income, and increases the level of activity in the economy. This should bring positive multiplier effects, and help to stimulate private sector investment, which helps to absorb spare capacity in the economy. This is crucial given that unemployment has started to rise. Although the unemployment rate remained very low at 3.9%, employment fell by 649 000 between March and June 2020. Given the nature of the economic crisis, many more job losses are expected.

Source: News reports, July 2020

Extract F: How should the money be spent?

As part of fiscal policy, government spending can be used to allocate resources to different regions and sectors of the economy and consequently, change the pattern of economic activity. For example, in his Summer Statement, the Chancellor of the Exchequer, Rishi Sunak, announced a £2 billion subsidy scheme to encourage householders to make energy-saving improvements, and £1.6 billion of support to help the arts industry. He also launched a £2 billion scheme to create jobs for young people and pledged to provide 30 000 new traineeships, which should help reduce the impact of occupational and geographical immobility.

Taxation also has a role to play in affecting the pattern of activity. Corporation tax can be altered to help create incentives to innovate. Indirect taxation can be used to influence consumers' behaviour. Examples of this include the so-called 'sugar tax' which was introduced to help deal with the growing obesity crisis, and the temporary reduction in VAT designed to support the hospitality industry.

However, significant increases in government spending, no matter how vital to the economy, will have to be accompanied by increases in taxation and/or even more government borrowing now and in the future. In addition, higher spending runs the risk of greater inflationary pressure. It will be important to ensure that the increases in spending are used appropriately and are worthwhile.

Source: News reports, July 2020

Turn over for Context 2 questions

Turn over ►

Context 2: – Questions 27 to 32

- 2 7** Define ‘unemployment rate’ **Extract E** (line 18). **[3 marks]**
- 2 8** If the government allocated £275 billion to social security spending in 2018–19, use **Extract D** to calculate, to the **nearest billion**, the total amount of government spending in 2018–19. **[4 marks]**
- 2 9** Use **Extract D** to identify **two** significant points of comparison regarding the composition of government spending between 1997–98 and 2018–19. **[4 marks]**
- 3 0** **Extract E** (line 15) states: ‘Government spending acts as an injection into the circular flow of income’.
- Draw an AD/AS diagram to show the effect of an increase in injections on the price level and national income. **[4 marks]**
- 3 1** **Extract F** (lines 1–2 and 8) states: ‘As part of fiscal policy, government spending can be used to allocate resources to different regions and sectors of the economy and consequently, change the pattern of economic activity...Taxation also has a role to play in affecting the pattern of activity’.
- Explain ways in which a government can use fiscal policy to affect the **pattern** of economic activity. **[10 marks]**
- 3 2** **Extract E** (lines 4–6) states: ‘...the report suggested that significant increases in spending would be required to help improve the wellbeing of the UK population’.
- Use the extracts and your knowledge of economics to assess the view that a long-term, significant increase in government spending would be beneficial for the UK economy. **[25 marks]**

END OF QUESTIONS**Copyright information**

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