Please check the examination details below before entering your candidate information

Candidate surname	Other names
StemUp Model Solution	

Centre Number | Candidate Number

Pearson Edexcel Level 3 GCE

Time 2 hours

Paper reference **9EC0/02**

Economics A

Advanced

PAPER 2: The National and Global Economy

You do not need any other materials.

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- There are three sections in this question paper. Answer **all** questions from Section A and Section B. Answer **one** question from Section C.
- Answer the questions in the spaces provided – *there may be more space than you need.*

Information

- The total mark for this paper is 100.
- The marks for **each** question are shown in brackets – *use this as a guide as to how much time to spend on each question.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Check your answers if you have time at the end.

Turn over ▶

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SECTION A

Answer ALL questions. Write your answers in the spaces provided.

Some questions must be answered with a cross in a box ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

You are advised to spend 30 minutes on this section.

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

1 According to the Bank of England, the UK's marginal propensity to consume is estimated to be 0.64.

(Source: adapted from https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2017/the-consumption-response-to-positive-and-negative-income-changes.pdf?)

(a) Using the information above, calculate the total reduction in the UK's GDP from a fall in government spending of £20 million.

(4)

Multiplier = 1 ÷ (1 – MPC)

= 1 ÷ (1 – 0.64) = 1 ÷ 0.36

Value of the multiplier = 2.7 recurring (2.78)

Total change in GDP = multiplier × change in government spending

= 2.78 × £20 million

Answer: GDP falls by £55.6 million (a reduction of –£55.6m)

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(b) Which **one** of the following is an injection into the circular flow of income?

(1)

- ☒ **A** Imports
- ☒ **B** Investment
- ☒ **C** Savings
- ☒ **D** Taxation

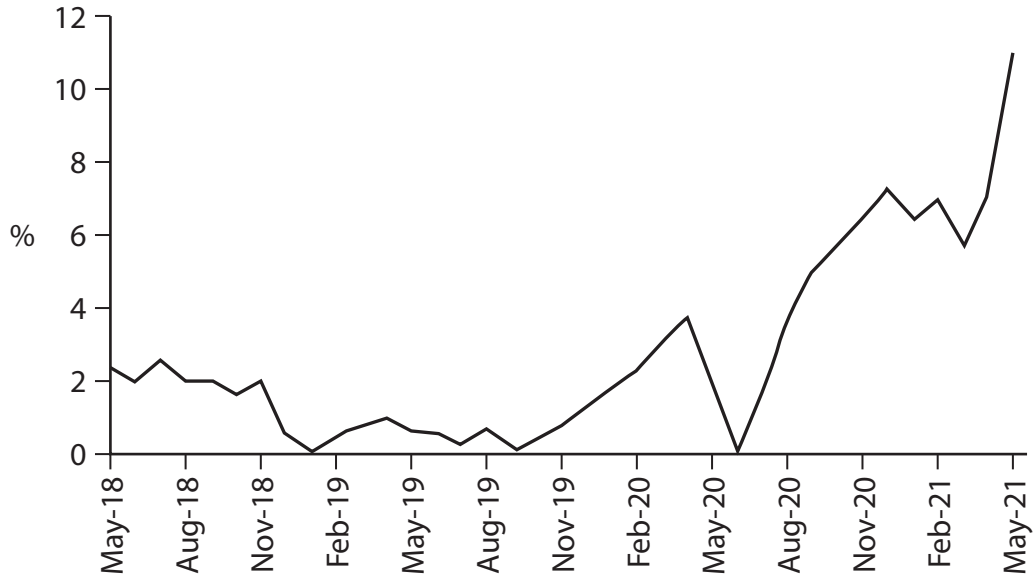
(Total for Question 1 = 5 marks)

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2 Annual percentage change in average UK house prices



(Source: adapted from https://www.nationwide.co.uk/-/media/MainSite/documents/about/house-price-index/2021/May_2021.pdf)

(a) With reference to the chart, which **one** of the following is true?

Average UK house prices:

(1)

- ☒ **A** fell in August 2020
- ☒ **B** fell in November 2018
- ☒ **C** rose the fastest in May 2021
- ☒ **D** stayed constant in 2018

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(b) With reference to the chart on the previous page, explain the likely impact of an increase in average house prices on UK consumption.

(4)

An increase in average house prices is likely to increase UK consumption. The chart shows house prices were rising throughout, for example by about 2% a year in November 2018 and by about 11% a year in May 2021.

Homeowners become wealthier because the value of their main asset rises, so through the wealth effect they feel richer and more confident and are less likely to save, spending more of their income. They can also borrow against the higher value of their homes (mortgage equity withdrawal) to fund spending on cars, holidays or home improvements, so consumption, and therefore AD, rises.

However, people who do not own a home may cut consumption and save more in order to afford a larger deposit.

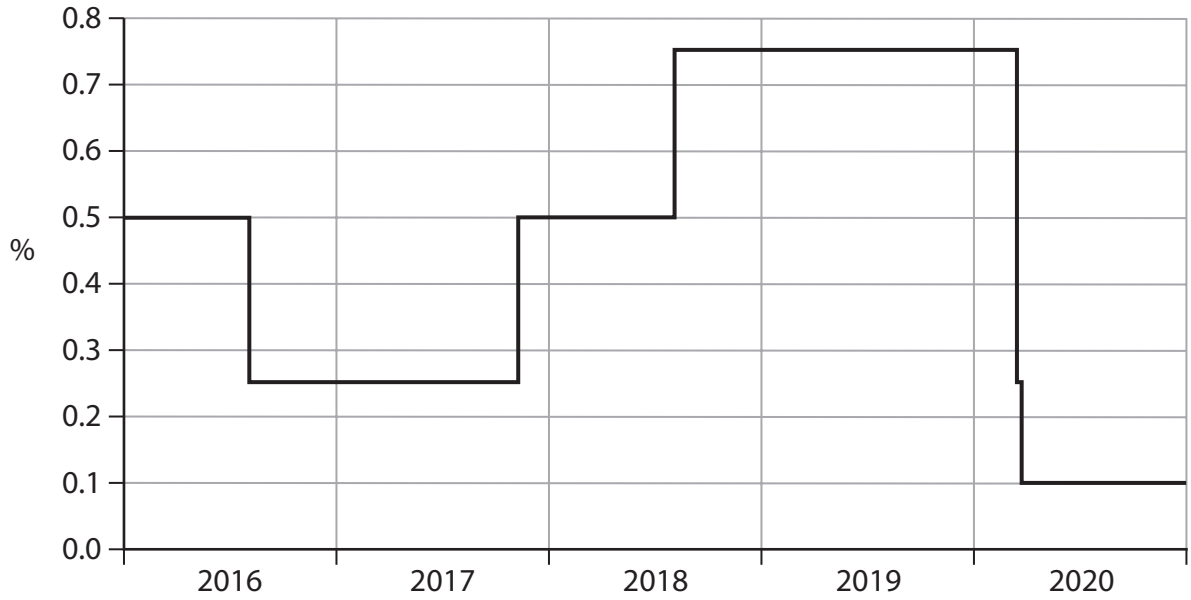
(Total for Question 2 = 5 marks)

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3 Bank of England base interest rate, 2016–2020



(Source: adapted from https://www.bankofengland.co.uk/monetary-policy/the-interest-rate-bank-rate)

(a) With reference to the chart above, explain the likely impact of a reduction in the base interest rate on UK investment.

(4)

A reduction in the base interest rate is likely to increase UK investment. The chart shows that in 2020 the base rate fell from 0.75% to 0.1%, a fall of 0.65 percentage points. Lower interest rates reduce the cost of borrowing, so firms are more incentivised to borrow money to buy capital goods such as machinery, new technology and buildings. Investment projects financed by borrowing are now more profitable, since the expected rate of return is more likely to exceed the cost of the loan, and they are less risky because repayments are lower.

The lower return on savings also encourages consumers to spend, raising expected sales, so firms feel more confident to invest to expand capacity.

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(b) Which **one** of the following would be most likely to result from lower base interest rates?

A fall in:

(1)

- ☒ **A** the average price of houses
- ☒ **B** the external value of the pound
- ☒ **C** the level of employment
- ☒ **D** the rate of economic growth

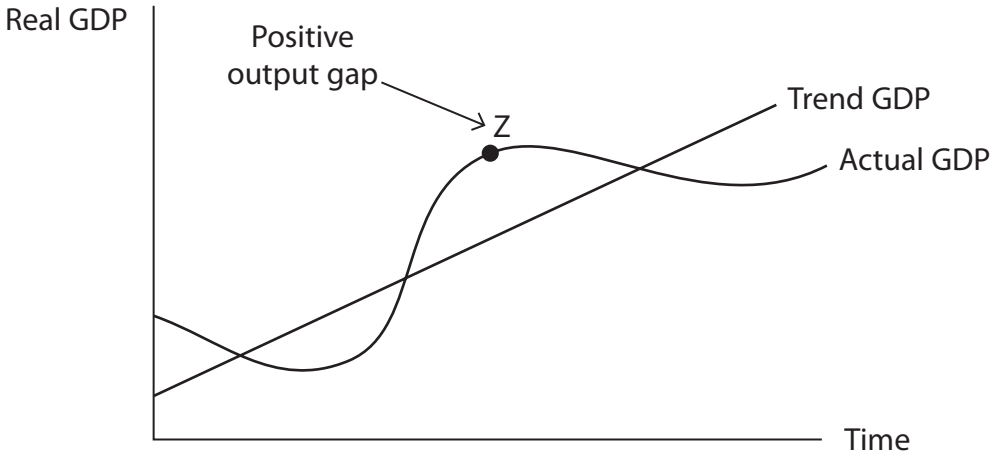
(Total for Question 3 = 5 marks)

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4 The trade cycle



(a) At point Z on the diagram, which **one** of the following is likely to occur?

An increase in:

(1)

- ☒ **A** absolute poverty
- ☒ **B** budget deficit
- ☒ **C** cyclical unemployment
- ☒ **D** inflation

(b) With reference to the graph, explain the difference between automatic stabilisers and discretionary fiscal policy.

(4)

Automatic stabilisers are changes in government spending and taxation that happen without any direct government decision over the course of the economic cycle, because they are built into progressive tax bands and means-tested welfare support. At point Z, in a positive output gap, incomes and spending are high, so tax revenues rise automatically and spending on benefits such as Jobseeker's Allowance falls, slowing the growth of AD. In a negative output gap, government spending rises and tax revenues fall automatically.

Discretionary fiscal policy is a deliberate alteration of government expenditure or tax rates, determined in the Budget, designed to achieve economic objectives. It could occur at any point on the trade cycle, e.g. a tax rise at Z to reduce inflation.

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(Total for Question 4 = 5 marks)

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5 In May 2020, the UK government introduced a loan scheme to help small businesses survive the downturn in the economy. Small businesses could borrow up to £50 000 at an interest rate of 2.5% for up to 6 years from a bank. The government guaranteed 100% of the loans, to enable banks to issue them quickly, and only minimal checks were made on borrowers.

(Source: adapted from https://www.ft.com/content/1ca15db2-93e4-4e34-877d-110309cd9716)

(a) With reference to the information above, explain **one** role of financial markets.

(4)

One role of financial markets is to lend to businesses and individuals to help them consume and invest.

Many small businesses needed a loan to help them survive the downturn in the economy in 2020, and could borrow up to £50 000 at an interest rate of 2.5% for up to 6 years from a bank.

Banks act as intermediaries, channelling savers' deposits to borrowers. Because businesses already had accounts with banks, the banks were in a position to issue these loans to their customers quickly. The loans provided finance for firms suffering a drop in demand, allowing them to pay wages and suppliers, so firms survived, jobs were protected and AD was supported.

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(b) Which **one** of the following would be a risk if 'only minimal checks were made on borrowers' in this loan scheme?

(1)

- ☒ **A** Asymmetric information
- ☐ **B** Crowding out
- ☐ **C** Market rigging
- ☐ **D** Speculation

(Total for Question 5 = 5 marks)

TOTAL FOR SECTION A = 25 MARKS

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SECTION B

Read Figures 1 and 2 and the following extracts (A to C) before answering Question 6.

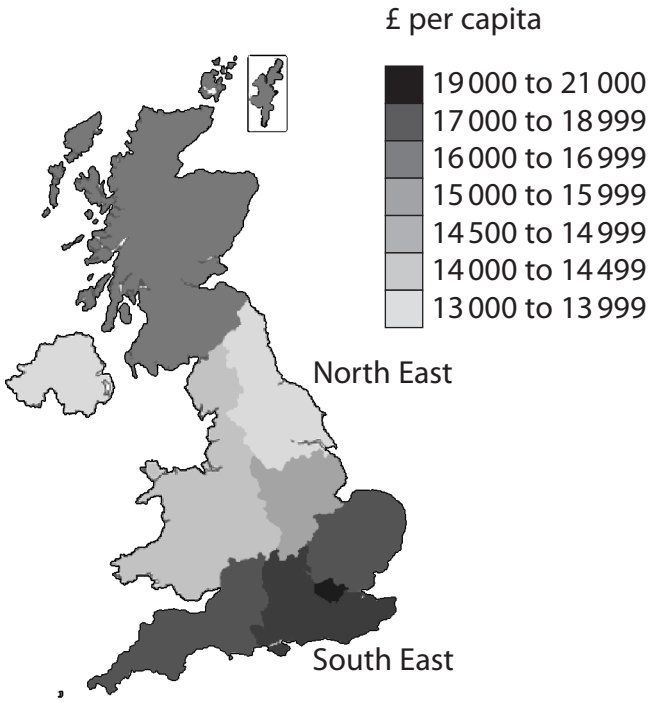
Write your answers in the spaces provided.

You are advised to spend 1 hour on this section.

Question 6

UK Government spending and inequality

Figure 1: UK regional gross disposable household income per capita, 2018



(Source: adapted from University of Sheffield/Office for National Statistics: https://www.sheffield.ac.uk/news/nr/uk-higher-regional-inequality-large-wealthy-country-1.862262)

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Figure 2: UK subjective happiness by income, April 2021

Answer to the question: 'On a scale of 1–10, how happy did you feel after yesterday?' (0 = not at all, 10 = completely)

Less than £10 000	£10 000–£20 000	£20 000–£40 000	More than £40 000
7.31	7.02	7.13	7.29

(Source: adapted from https://www.ons.gov.uk/peoplepopulationandcommunity/wellbeing/datasets/incomegroupsplitestimatesonpersonalandeconomicwellbeingacrosstime)

Extract A

Regional inequality in the UK

Geographically, the UK is highly unequal in incomes. According to research from the University of Sheffield, the estimate of the Gini coefficient is 0.34. There are a number of different reasons for this. First, labour in poor places tend to develop too few skills, with a lack of education holding people back. In Rotherham in the north of England, for example, 21% of disadvantaged 18-year-olds from state schools and colleges go on to higher education compared to 41% in London. Secondly, there is a lack of infrastructure spending in northern cities compared to London. In 2017–18, 28% of public expenditure on transport – and 46% of capital expenditure on railways – was spent in London. The argument for this is that London gets a lot of public money because a lot of people take public transport. This has angered many people in the North.

These problems cannot be solved quickly. They compound each other. Just as people are rarely poor for one reason, regions do not fall behind only because they have poor transport, poor schools or poor policy making, but for all those reasons and more. Ideally, the UK would develop a bold plan for regional development that could be followed by future governments, as Germany did for its eastern part. Tera Allas of McKinsey, a consultancy firm, argues that improving education is crucial, even if the returns are not immediately obvious. It is easier to improve schools than to persuade businesses to move to a poorer part of the country.

(Source: adapted from https://www.economist.com/britain/2020/07/30/why-britain-is-more-geographically-unequal-than-any-other-rich-country)

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Extract B

Public sector spending on infrastructure

Economic differences across the UK are large and have grown. The government is looking at reducing this inequality partly through spending on transport infrastructure. Public sector capital spending is due to rise from just over 2% of GDP to 3%. That amounts to around £20 billion of additional spending per year on new capital projects. The government is looking to take advantage of current low interest rates to finance the expansion without worsening its fiscal position.

The government is determined to focus this spending on the north of England, Wales and the Midlands. Planned schemes include a new Trafford Park tram line in Manchester and reopening train lines and stations closed back in the 1960s, including stations in Haxby in Yorkshire and Blyth in Northumberland. Progress has already been made in Wales with the reopening of Bow Street station near Aberystwyth. This project has taken 11 years to become a reality and cost £8m. It is estimated that it will generate a boost to the economy of £24m through boosting local trade, creating new jobs in the local area, and easing pressure on congested roads heading into Aberystwyth.

(Source: adapted from https://www.economist.com/britain/2020/01/09/the-coming-splurge-on-northern-infrastructure and https://www.wales247.co.uk/transport-for-wales-delivers-new-bow-street-station)

Extract C

Options for UK tax rises in the future

There are a number of options for raising additional tax revenue in the future. These include:

- increasing council tax on houses: this annual charge paid to local government is currently based on estimated house prices in 1991 and so is very out of date. This would negatively affect areas where house prices have risen the most since 1991
- a one-off wealth tax: a 5% tax on property and pension wealth of more than £500 000 would raise £260 billion to help pay for the global health crisis in five years, according to proposals from the Wealth Commission
- increasing corporation tax: at the 2021 Budget the Chancellor announced that the top rate of UK corporation tax would be increased to 25% by 2023. This will remain the lowest rate in the G7 group of the world's largest advanced countries, but will raise £17.2 billion in 2025–26.

(Source: adapted from https://www.telegraph.co.uk/tax/income-tax/five-tax-rises-rishi-sunak-considering-chances-happening-budget/, and https://home.kpmg/uk/en/home/insights/2021/03/tmd-corporation-tax-rate-to-increase-to-25-percent.html)

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6 (a) Using a Lorenz curve diagram, explain how income inequality is measured using the Gini coefficient. Refer to Extract A in your answer.

(5)

(b) With reference to Figure 1 and Extract A, examine **two** likely causes of income inequality within the UK.

(8)

(c) With reference to Figure 2, assess whether an increase in real income improves subjective happiness within the UK.

(10)

(d) With reference to Extract C and your own knowledge, discuss methods the UK government could use to increase tax revenue.

(12)

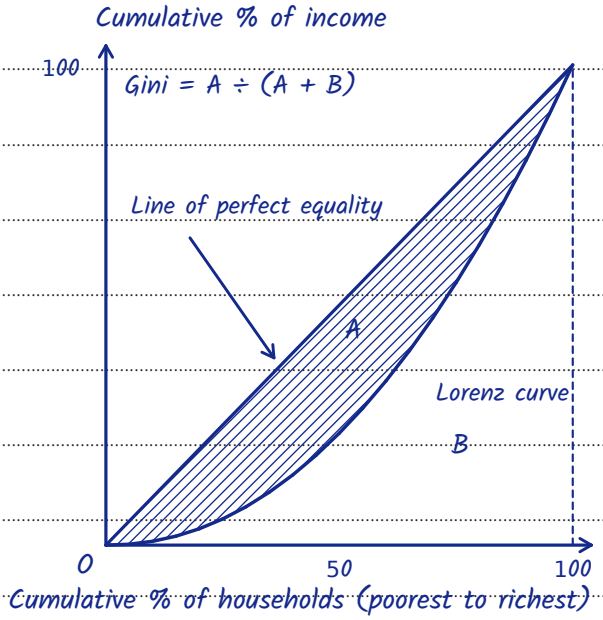
(e) With reference to Extract B, discuss the benefits of an increase in infrastructure spending on the UK economy. Use an aggregate demand and aggregate supply diagram to support your answer.

(15)

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6 (a) Using a Lorenz curve diagram, explain how income inequality is measured using the Gini coefficient. Refer to Extract A in your answer.

(5)



The Lorenz curve shows the cumulative percentage of income received by the cumulative percentage of households, ranked from poorest to richest. The diagonal is the line of perfect equality, where e.g. 50% of households receive 50% of income.

The Gini coefficient is calculated as the area A (between the line of perfect equality and the Lorenz curve) divided by the total area A + B under the diagonal: Gini = A ÷ (A + B). It ranges from 0 (perfect equality) to 1 (perfect inequality).

The further the Lorenz curve is from the line of perfect equality, the larger area A is, so the higher the Gini coefficient and the more unequal the country or region. Extract A states the UK's Gini coefficient is estimated at 0.34, so the UK has a moderate, but significant, degree of income inequality.

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(b) With reference to Figure 1 and Extract A, examine **two** likely causes of income inequality within the UK.

(8)

Figure 1 shows large regional inequality: gross disposable household income per capita was £19 000 to £21 000 in London but only £13 000 to £13 999 in the North East in 2018, and the UK's Gini coefficient is 0.34.

The first cause is differences in the level and quality of education. Extract A states that in Rotherham only 21% of disadvantaged 18-year-olds from state schools go on to higher education, compared with 41% in London. Less education means the workforce in poorer regions is less skilled and less productive, so workers have lower marginal revenue product and receive lower average pay. Highly skilled, higher-paying jobs in finance and professional services are concentrated in London and the South East, while jobs in the North East are more likely to be low skilled and low paid, widening income inequality.

The second cause is the level of infrastructure spending. In 2017 to 2018, 28% of public expenditure on transport and 46% of capital expenditure on railways was spent in London. A relative lack of infrastructure in northern cities makes it harder for people to get to work and reduces geographical mobility of labour, and discourages firms from investing in the region because of higher transport costs. Fewer firms mean fewer job opportunities and lower wages, so incomes in the North stay below those in London.

However, it is hard to be definite about specific causes, as Extract A says the problems 'compound each other' and regions fall behind for all these reasons and more, so it is a combination of factors. Education may be the more significant cause, as Tera Allas argues improving schools is crucial, but higher education may not always lead to higher incomes, depending on the degree. Infrastructure investment in the North of England is now increasing (Extract B), so this cause may become less important in the future.

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(c) With reference to Figure 2, assess whether an increase in real income improves subjective happiness within the UK.

(10)

Real income is income adjusted for inflation, so it measures the quantity of goods and services people can actually buy. Subjective happiness is how happy people say they feel, a measure of well-being.

An increase in real income may improve happiness because people have more money to spend on goods and services that increase their standard of living, such as better housing, food and leisure. Higher incomes also mean people feel less anxious about their ability to repay debts, and can afford larger repayments on mortgages and loans for durable goods. Higher income may also lead to wealth creation, as people are able to save for the future and for retirement, giving financial security.

Figure 2 supports this to some extent: people earning more than £40 000 scored 7.29 out of 10, higher than those earning £10 000 to £20 000 (7.02) and £20 000 to £40 000 (7.13). So for most income groups, moving to a higher income band raises happiness.

However, the evidence is mixed. The happiest group in Figure 2 is those earning less than £10 000, with a score of 7.31, higher than any other group, so higher income does not necessarily improve happiness. The differences are also very small, only 0.29 points between the highest and lowest scores, suggesting income has only a weak link with well-being. This is consistent with the Easterlin paradox: beyond a certain level of income, further increases do not make people much happier, due to diminishing marginal utility of income.

There are many other things that affect subjective happiness apart from money, such as relationships with family and friends, health, job security and the amount of leisure time, which may be more important than the level of income. People on higher incomes may be in more stressful jobs and work longer hours, reducing happiness. People may also judge their income relative to others, so if everyone's real income rises, relative position and happiness may not change.

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Finally, the reliability of the survey data is limited: it is based on one question about how happy people felt 'after yesterday' in April 2021, during the global health crisis, so answers may reflect short-term events. The data also show income groups, not what happens when an individual's real income increases.

Overall, an increase in real income can improve happiness, especially for those on low incomes for whom it allows basic needs to be met, but Figure 2 suggests the effect within the UK is small, and other factors are likely to matter more.

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(d) With reference to Extract C and your own knowledge, discuss methods the UK government could use to increase tax revenue.

(12)

Tax revenue is the money the government receives from taxes such as income tax, VAT, council tax and corporation tax. Extract C outlines several methods to raise more.

Firstly, the government could increase council tax on houses. This annual charge is based on estimated house prices in 1991, so it is very out of date. Housing is a large part of the UK economy and house prices have risen greatly since 1991, so revaluing homes would increase the tax base and provide a good opportunity to increase overall revenue every year. As property cannot move abroad, the tax is hard to avoid.

Secondly, a one-off wealth tax of 5% on property and pension wealth of more than £500 000 would raise a very large amount of money, £260 billion, to help pay for the global health crisis. It focuses on those with the most wealth, so it is progressive and could reduce wealth inequality. As it is only one-off, it should not have long-term disincentive effects on work or saving.

Thirdly, the government could increase corporation tax, a tax on company profits, which will rise to 25% by 2023 and raise £17.2 billion in 2025 to 2026. As this will still be the lowest rate in the G7, it makes sense to raise it without risking too many firms leaving the UK, while still raising extra revenue every year.

Alternatively, the government could cut tax rates. According to the Laffer curve, if tax rates are above the revenue-maximising rate, cutting income tax would give workers more incentive to work harder and less incentive to avoid or evade tax, and cutting corporation tax would attract FDI and increase investment, so profits, incomes and output grow and tax revenue rises.

However, higher tax rates may not lead to higher revenue: with reference to the Laffer curve, high rates create a disincentive effect and increase tax avoidance and evasion. Higher corporation tax may deter investment and FDI, having a long-term negative impact on LRAS

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and growth, and multinationals may shift profits abroad.

Updating council tax could see some households, such as retired people in London and the South East where prices have risen most, face a significant rise in tax that may be unaffordable for them, as they are asset rich but cash poor. Council tax is also regressive relative to income, which could worsen inequality.

A one-off wealth tax will not help generate tax revenue in the long term. It is difficult to value assets such as pensions, and the wealthy may move assets abroad before it is introduced.

In conclusion, increasing corporation tax is likely to be the most reliable method in the long run, because the UK rate remains low by international standards, whereas the wealth tax raises a large sum only once. The best method depends on where the UK lies on the Laffer curve and on the government's equity objectives.

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(e) With reference to Extract B, discuss the benefits of an increase in infrastructure spending on the UK economy. Use an aggregate demand and aggregate supply diagram to support your answer.

(15)

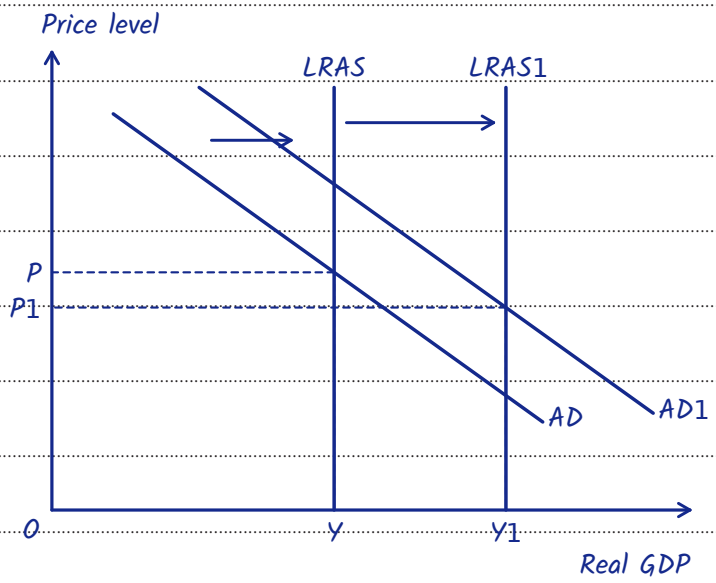
Infrastructure spending is government capital spending on things such as roads, railways, trams and broadband. Extract B states public sector capital spending is due to rise from just over 2% of GDP to 3%, around £20 billion of additional spending per year, focused on the north of England, Wales and the Midlands.

In the short run, infrastructure spending is an injection into the circular flow of income, increasing government spending (G), a component of AD = C + I + G + (X − M). AD shifts right from AD to AD1 in my diagram. Construction firms hire more workers and buy more materials, and through the multiplier effect workers spend their extra incomes in other parts of the economy, so the final increase in real GDP is greater than the initial injection. For example, Bow Street station cost £8m but is expected to generate a £24m boost to the economy, implying a multiplier effect of about 3.

In the long run, infrastructure increases the productive capacity of the economy, shifting LRAS right from LRAS to LRAS1, so real GDP rises from Y to Y1 with less inflationary pressure, giving sustainable economic growth. Better transport, such as the new Trafford Park tram line in Manchester, means people can access jobs further away from where they live, improving geographical mobility of labour and reducing unemployment. Firms can transport goods around the country and abroad more quickly and cheaply, reducing costs and improving productivity and international competitiveness. Easing pressure on congested roads, as in Aberystwyth, cuts journey times.

Infrastructure also helps to reduce inequality across the country by focusing spending on poorer areas, such as reopening stations in Haxby and Blyth and the new station in Wales, leading to new businesses, local trade and jobs. Better infrastructure makes the North more attractive for private investment, which could reduce the regional inequality shown in Figure

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1.

However, the significance of the impact is uncertain: will a few new train stations make much difference to economic growth? £20 billion a year is under 1% of UK GDP, so the effect on AD and LRAS may be small. The benefits also depend on the quality of the new infrastructure and whether it is in the right location to improve connectivity; if it simply makes it easier for people to commute to London, it may not help northern economies.

There are long time lags: Bow Street station took 11 years to become a reality, so the supply-side benefits may not be felt for many years. Large projects often overrun on cost, which may be a sign of government failure.

There is also an opportunity cost: spending on education or healthcare might have a larger impact on productivity and inequality, as Extract A suggests improving education is crucial.

The extra spending could worsen public finances and increase national debt; although low interest rates make borrowing cheap now, if interest rates rise, debt interest payments will increase. Government borrowing may also crowd out private sector investment if it raises interest rates.

Finally, the size of the benefit depends on the value of the multiplier: with a high marginal propensity to import, part of the injection leaks out of the UK economy. If the economy is

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near full capacity, the increase in AD may cause inflation rather than higher output.

In conclusion, infrastructure spending is likely to benefit the UK economy through higher AD in the short run and higher productive capacity in the long run, especially for poorer regions. However, the scale of benefits depends on the choice of projects, their quality and location, time lags and how the spending is financed.

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(Total for Question 6 = 50 marks)

TOTAL FOR SECTION B = 50 MARKS

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SECTION C

Answer ONE question from this section.

Write your answer in the space provided.

You are advised to spend 30 minutes on this section.

EITHER

7 Both China and the United States have been gradually increasing the tariffs imposed on each other's exports as their trade dispute continues. The IMF estimated that the trade dispute between China and the United States would reduce global GDP growth by 0.8 percentage points by the end of 2020.

(Source: adapted from https://www.theguardian.com/business/2019/oct/15/imf-recession-world-growth-forecast-central-banks)

Evaluate the likely impact of an increase in protectionism on the global economy.

(Total for Question 7 = 25 marks)

OR

8 With global economic growth slowing and inequality rising, the case against globalisation is strengthening. But there are also many benefits to globalisation. Global trade and international trade agreements allow countries to focus on their strengths and share expertise, as well as reducing risk through diversification.

(Source: adapted from https://www.ft.com/content/7b365844-9b75-11ea-adb1-529f96d8a00b)

Evaluate the likely impact of globalisation on the global economy.

(Total for Question 8 = 25 marks)

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Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

Chosen question number: **Question 7** ☒ **Question 8** ☒

Write your answer here:

Question 7

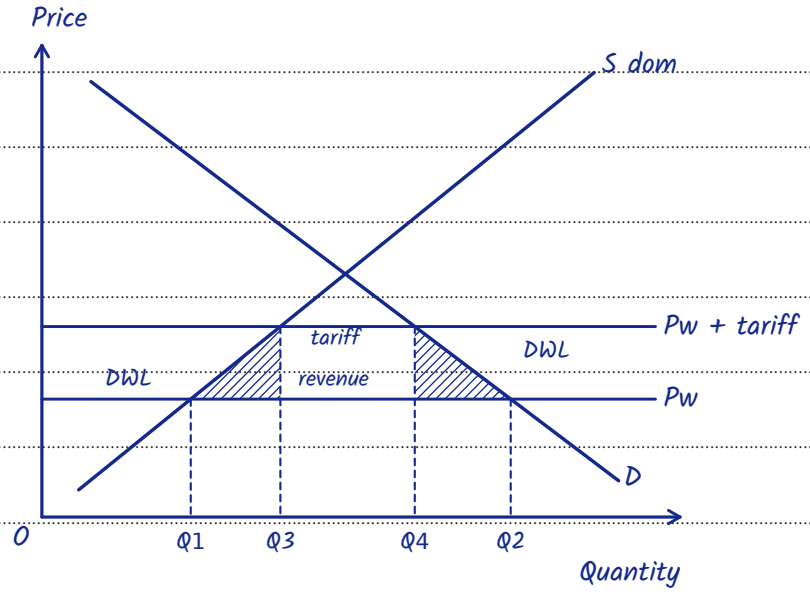
Protectionism is the use of trade barriers, such as tariffs, quotas, subsidies to domestic producers and non-tariff barriers, to restrict imports and protect domestic industries. A tariff is a tax on imports. The global economy is the network of trade, investment and financial flows between all countries.

Firstly, tariffs raise prices for consumers. In my diagram, a tariff raises the domestic price from the world price Pw to Pw + tariff. Domestic demand falls from Q2 to Q4 and domestic supply rises from Q1 to Q3, so imports fall from Q1Q2 to Q3Q4. Consumers pay higher prices, especially for goods that cannot be produced domestically, such as bananas in the UK, and for goods where domestic firms now face less competition from abroad and can raise prices. Consumers also have less choice as imports become too expensive. As many countries raise tariffs, this increases inflation globally and reduces real incomes.

Secondly, protectionism causes a deadweight welfare loss, shown by the two hatched triangles. Resources are diverted to less efficient domestic producers, and consumers who would have bought at the world price no longer do so. Globally, this reduces allocative and productive efficiency.

Thirdly, protectionism reduces the gains from comparative advantage. When countries specialise in goods they can produce at the lowest opportunity cost and trade, world output is maximised. Higher tariffs encourage countries to produce goods in which they are relatively inefficient, leading to less productivity and less output. Fewer firms may decide to export because of increased costs and bureaucracy, reducing global competition, so global GDP is lower and global inflation is higher. The IMF estimated that the trade dispute between China and the United States would reduce global GDP growth by 0.8 percentage points by

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the end of 2020.

Fourthly, protectionism often leads to retaliation. When the US increased tariffs on Chinese exports, China responded with tariffs on US goods, such as soybeans, damaging US farmers. Such trade wars reduce the volume of world trade, disrupt global supply chains and reduce business confidence and FDI. Because China and the US are the two largest economies, slower growth in these countries reduces their demand for imports from other countries, such as commodity exporters in Africa and Latin America, so the effect spreads across the global economy through lower exports and incomes.

Developing countries may be hit hardest, as export-led growth has been a key route out of poverty. Tariffs on their exports reduce incomes, employment and investment, increasing global inequality and absolute poverty.

However, the impact depends on the level of tariffs that countries introduce. Small tariffs on a narrow range of goods will have little effect on world trade, and the 0.8 percentage point fall is small compared with global growth of around 3%. The trade dispute may only be short term, as countries such as the US and China could negotiate and agree new terms, as they did in the 2020 'phase one' trade deal. The WTO can also enforce global trade rules and settle disputes to ensure countries do not distort international trade.

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Protectionism may also have benefits. Protection of domestic industries helps to protect domestic employment and income in industries threatened by cheap imports, and can help reduce inequality within countries where globalisation has caused structural unemployment. Infant industry protection gives new industries in developing countries time to grow and benefit from economies of scale so they can compete internationally in the long run; South Korea and China used this strategy successfully. Protectionism can also protect an economy from dumping, where foreign firms sell below cost, which would otherwise lead to loss of jobs and output.

Comparative advantage can also encourage over-dependence, for example primary product dependency in developing countries that rely on volatile commodity prices; some protection may help these countries diversify. However, the theory assumes no transport costs and perfect factor mobility, so the real gains from free trade may be smaller than predicted.

In conclusion, an increase in protectionism is likely to have a negative impact on the global economy, through higher prices, less choice, deadweight welfare loss, lost gains from specialisation and lower global growth. The size of the impact depends on how high and widespread the tariffs are, whether retaliation escalates and how long the dispute lasts. Targeted, temporary protection, such as anti-dumping duties or infant industry support, can be justified, but a wide trade war between the two largest economies is likely to reduce global welfare overall.

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Question 8

Globalisation is the increasing integration and interdependence of the world's economies, through greater trade in goods and services, flows of capital (such as FDI), movements of labour, and the spread of technology and information. It has been driven by lower transport and communication costs, trade liberalisation through the WTO and trade agreements, and the growth of multinational corporations (MNCs).

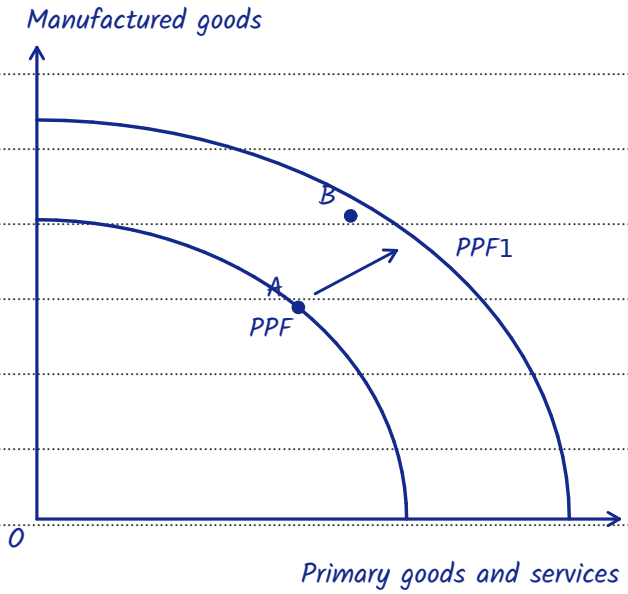
Firstly, globalisation increases global trade and global output through comparative advantage. Countries can focus on their strengths, specialising in the goods and services they can produce at the lowest opportunity cost, and trade their surplus. Resources are allocated more efficiently, so world output and living standards rise. In my diagram, global production capacity increases, shifting the PPF outwards to PPF1, so the world can move from point A to B, consuming more of both goods.

Secondly, globalisation increases incomes in developing countries due to the growth of export industries and investment from MNCs. FDI brings capital, technology and management skills, creating jobs and raising productivity. China, Vietnam and Bangladesh have achieved rapid economic growth through export-led manufacturing, lifting hundreds of millions of people out of absolute poverty, which helps to reduce global inequality between countries.

Thirdly, increased global competition between firms leads to lower prices and more choice for consumers globally. Firms must become more efficient and innovative to compete, and can exploit economies of scale by selling to a global market. Increased supply from low-cost producers also reduces global inflationary pressures, which helped keep inflation low in many advanced economies in the 2000s.

Fourthly, increased migration can reduce unemployment globally as people move to where jobs are available and where their skills are in need, filling skill shortages, while remittances sent home raise incomes in developing countries. As the extract states, international trade agreements allow countries to share expertise and reduce risk through diversification of

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markets and suppliers.

However, globalisation has costs. The extract notes inequality is rising. Within advanced economies, industries such as manufacturing close down due to competition from lower-cost countries, causing structural unemployment, particularly for low-skilled workers who are occupationally and geographically immobile. Increased production in countries with lower labour costs may reduce inequality between countries but increase inequality within them. MNCs may exploit workers in countries with weak regulations, paying low wages in poor working conditions, and use transfer pricing to avoid tax, reducing government revenue. Increased transport of goods around the world increases pollution and carbon emissions, a negative externality contributing to climate change.

Greater global integration of supply chains increases the chance of delays in transport and delivery around the world, as seen during the global health crisis when shortages of semiconductors disrupted car production worldwide. Over-reliance on imports is encouraging more firms and countries to look at domestic production. Financial globalisation also means shocks spread quickly, as in the 2008 financial crisis, which began in the US and caused a global recession.

The extract notes that global growth is slowing and the case against globalisation is

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strengthening. The growth of protectionism, such as the US and China trade dispute and Brexit, may restrict global trade and limit the gains from comparative advantage, so the benefits of globalisation may be smaller in future.

The impact also differs between countries: emerging economies in Asia have benefited greatly, while some countries in Sub-Saharan Africa remain dependent on primary products with volatile prices and have gained less. Within countries, the gains depend on whether governments use policies such as retraining, education and redistribution to support workers who lose out.

In conclusion, globalisation is likely to have had a positive overall impact on the global economy, raising world output, trade and incomes, lowering prices and reducing absolute poverty. However, the benefits are unevenly distributed and come with costs such as structural unemployment, inequality, environmental damage and greater vulnerability to global shocks. The net impact depends on the policies governments adopt to share the gains more widely.

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