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

Monday 20 May 2024

Afternoon (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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Pearson

SECTION A

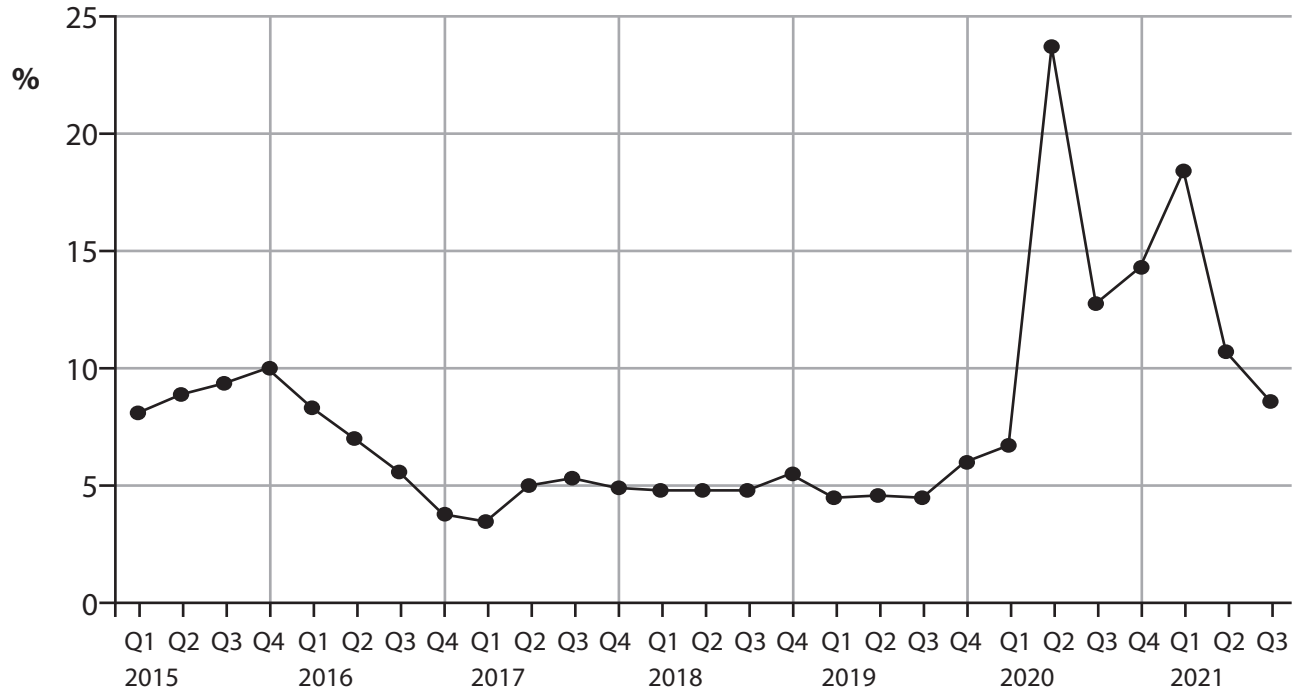
Answer ALL questions. Write your answers in the spaces provided.

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 UK household savings as a percentage of household disposable income, quarter 1 (Q1) 2015 to quarter 3 (Q3) 2021



(Source: https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/dgd8/ukea)

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

(1)

UK household savings as a percentage of household disposable income:

- ☒ **A** fell in 2015
- ☒ **B** fell throughout the time period shown
- ☒ **C** were the highest in Q1 2017
- ☒ **D** were the highest in Q2 2020

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(b) In Q4 of 2015 average household disposable income was £26 300.

Calculate the total amount of money saved by the average household in Q4 of 2015.

(2)

Savings ratio in Q4 2015 = 10% of disposable income

10% × £26 300 = 0.1 × £26 300

Amount saved = £2 630

(c) Explain **one** likely reason for the change in total household savings from Q1 2020 to Q2 2020.

(2)

Savings rose sharply from about 6.7% to about 23.7% of disposable income because of the global health crisis (Covid-19 lockdowns): shops, restaurants and travel were closed, so consumers were unable to spend.

Falling consumer confidence and fear of losing their job during the recession also made households unwilling to spend, so they saved more as a precaution.

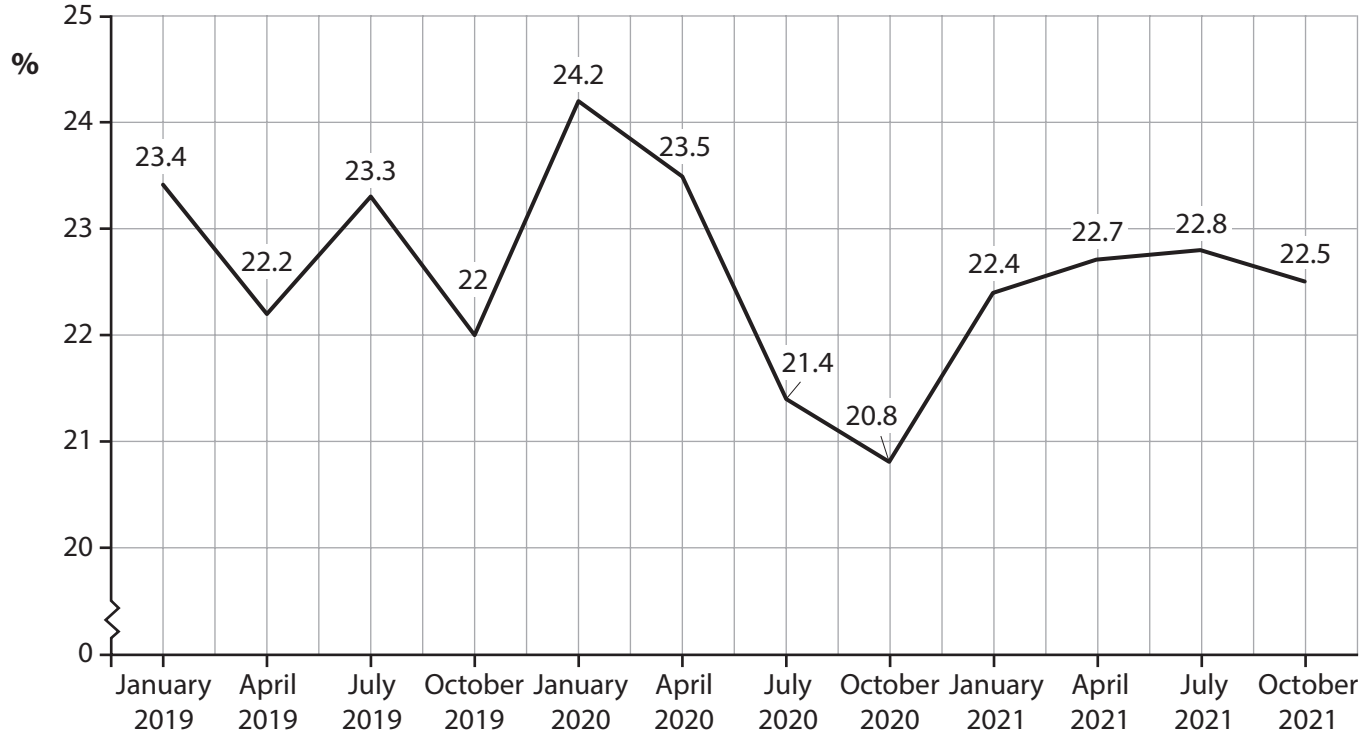
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2 Investment in the European Union, percentage of GDP, January 2019 to October 2021



(Source: adapted from https://www.ceicdata.com/en/indicator/european-union/investment--nominal-gdp)

(a) Which **one** of the following is the percentage point fall in investment between April 2020 and July 2020?

(1)

- ☒ **A** 0.1
- ☒ **B** 0.6
- ☒ **C** 2.1
- ☒ **D** 8.9

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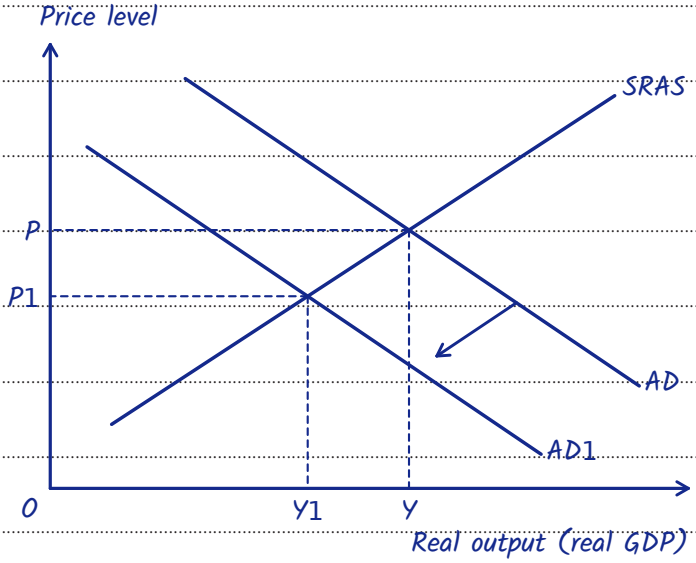
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(b) With reference to the data, explain **one** likely effect of the fall in investment in 2020.

(4)

Investment fell from 24.2% of GDP in January 2020 to only 20.8% in October 2020, a fall of 3.4 percentage points.

Investment is a component of aggregate demand (AD = C + I + G + X − M), so lower injections into the circular flow of income shift AD left from AD to AD1. With reduced multiplier effects, real output falls from Y to Y1 and the price level falls from P to P1, reducing economic growth and increasing unemployment. In the long run less capital investment reduces productivity and productive potential (LRAS).



(Total for Question 2 = 5 marks)

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3 A group of banks, including Barclays and JP Morgan, have been fined more than €1 billion by the EU's competition authorities for rigging the foreign exchange market after the Global Financial Crisis of 2008. The EU found that traders at the banks had used online chat rooms to share information about customers' orders, prices and other trading activities in order to manipulate the currency markets.

(Source: adapted from https://www.ft.com/content/73163fa0-77c5-11e9-bbad-7c18c0ea0201)

(a) With reference to the information above, explain what is meant by 'market rigging'.

(4)

Market rigging is when firms in a financial market collude, acting like a cartel, to illegally manipulate the price, here the exchange rate, rather than letting it be set by supply and demand. It is a form of market failure in financial markets, a symptom of oligopoly and of asymmetric information.

Traders at banks such as Barclays and JP Morgan used online chat rooms to share information about customers' orders and prices in order to manipulate the currency markets. The banks made additional profits, while customers lost out because exchange rates were not where they would be in a competitive market. The EU fined the banks more than €1 billion.

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(b) Which **one** of the following is a role of financial markets?

To:

(1)

- ☒ **A** discourage saving
- ☒ **B** promote moral hazard
- ☒ **C** provide forward markets
- ☒ **D** restrict free trade

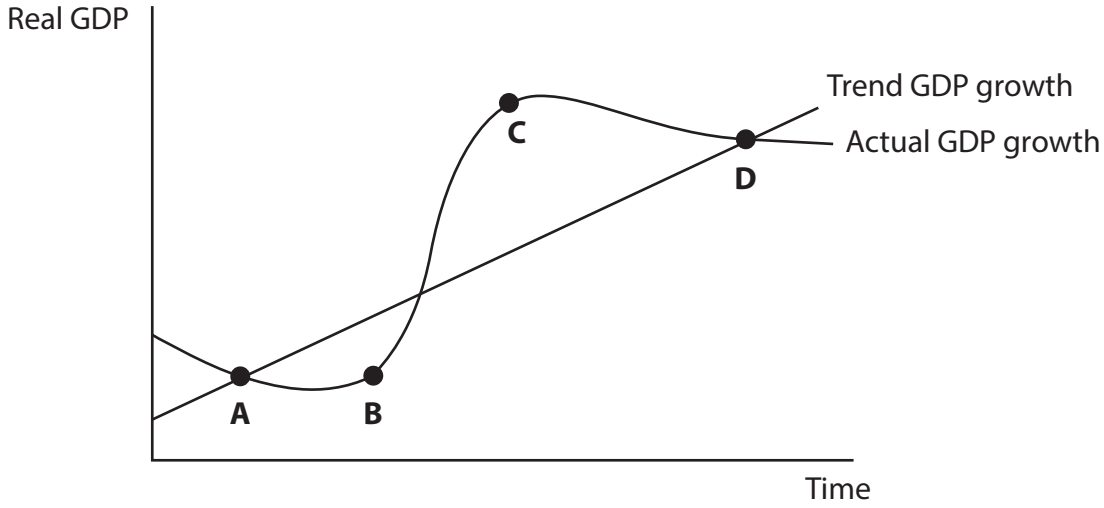
(Total for Question 3 = 5 marks)

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(a) Which **one** point on the trade cycle diagram above illustrates a boom?

(1)

- ☒ **A**
- ☒ **B**
- ☒ **C**
- ☒ **D**

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(b) In July 2020 a survey estimated that the marginal propensity to consume in the UK was 0.1.

(Source: adapted from https://ifs.org.uk/uploads/WP202035-MPCs-through-COVID-spending-saving-and-private-transfers.pdf)

Calculate the total increase in aggregate demand from an increase in government spending of £60 million.

(4)

Multiplier = 1 ÷ (1 − MPC)

= 1 ÷ (1 − 0.1) = 1 ÷ 0.9

Multiplier = 1.11 (recurring)

Total increase in AD = multiplier × change in government spending

= 1.11 × £60 million

Total increase in aggregate demand = £66.6 million

(Total for Question 4 = 5 marks)

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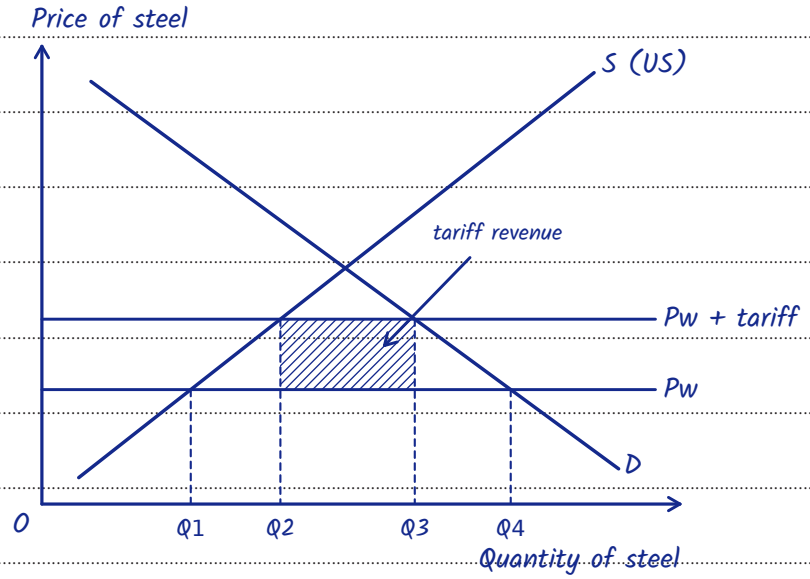
5 In March 2018 the US imposed a tariff of 25% on steel imports from the UK.

(Source: adapted from https://www.reuters.com/business/us-uk-announce-plans-formal-talks-metals-tariffs-wednesday-sources-2022-01-19/)

(a) Explain the likely impact of this tariff on the steel market in the US.

(4)

A 25% tariff on UK steel imports raises the price of steel in the US from Pw to Pw + tariff. US producers extend supply from Q1 to Q2, protecting the domestic steel industry and jobs, and gain producer surplus and higher profits. Demand contracts from Q4 to Q3, so imports fall from Q1Q4 to Q2Q3. US consumers lose consumer surplus as they pay higher prices, there is a deadweight loss, and the US government gains the shaded tariff revenue.



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(b) Which **one** of the following is likely to give the US a comparative advantage in steel production?

An increase in:

(1)

- ☐ **A** corporation tax in the US
- ☐ **B** economic growth in the US
- ☒ **C** the productivity of US steel workers
- ☐ **D** the wages of US steel workers

(Total for Question 5 = 5 marks)

TOTAL FOR SECTION A = 25 MARKS

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SECTION B

Read Figures 1, 2, 3 and 4 and the following extracts (A and B) before answering Question 6.

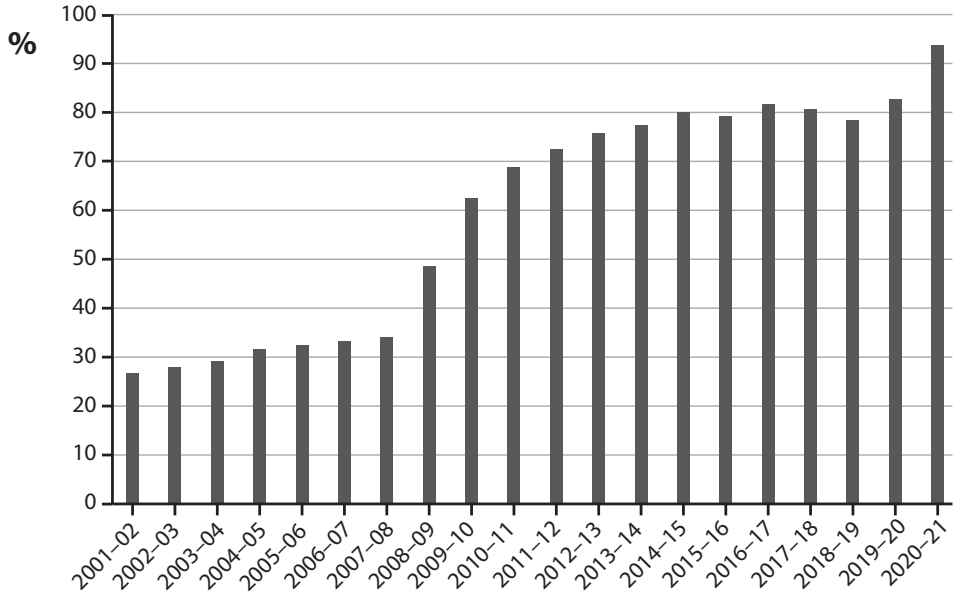
Write your answers in the spaces provided.

You are advised to spend 1 hour on this section.

Question 6

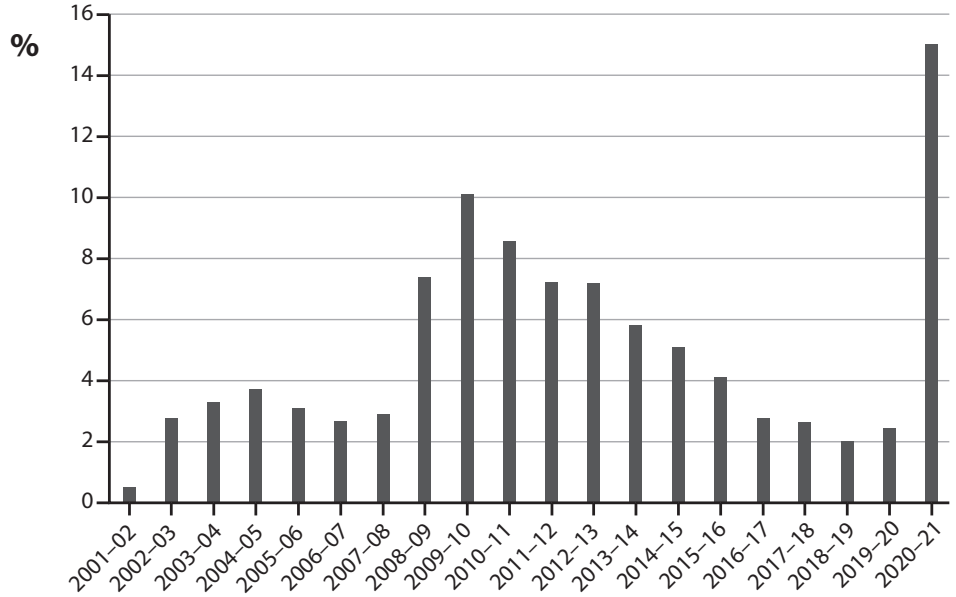
The UK Economy

Figure 1: UK national debt, percentage of GDP, 2001–2021



(Source: https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/december2021)

Figure 2: UK fiscal deficit, percentage of GDP, 2001–2021



(Source: https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/december2021)

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Figure 3: Interest rate on a 10-year UK government bond, July 2022 to March 2023



(Source: https://www.ft.com/content/ece962c3-b7e5-48c6-a0b1-06f9823a4853#post-ad2ac225-0543-49e7-9ed5-af9907e83697)

Figure 4: Income tax rates for 2023–24, compared to 2022–23

	2022–23		2023–24	
Tax band	**Income threshold**	**Tax rate**	**Income threshold**	**Tax rate**
Personal allowance	Up to £12 570	**0%**	Up to £12 570	**0%**
Basic rate	£12 571–£50 270	**20%**	£12 571–£50 270	**20%**
Higher rate	£50 271–£150 000	**40%**	£50 271–£125 140	**40%**
Additional rate	Over £150 000	**45%**	**Over £125 140**	**45%**

(Source: Gov.uk)

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Extract A

Freeze in income tax thresholds from 2023 onwards

The freeze on the personal allowance, and the basic and higher-rate income tax bands in England, Wales and Northern Ireland will be extended to April 2028. While this freeze may not look like a tax rise on the face of it, having thresholds that fail to rise in line with salaries, people will still end up paying more tax on their income – particularly if they end up in a higher tax band as a result.

The biggest change announced in the Autumn Statement 2022 was the reduction of the additional-rate income tax threshold, dropping from £150 000 to £125 140 from 6 April 2023. It is estimated around 250 000 taxpayers will be pushed into the additional rate tax band, paying 45% tax on any income above the new limit.

The Chancellor said lowering the additional rate threshold means that a person earning £150 000 will pay an extra £1 200 income tax per year.

(Source adapted from: https://www.which.co.uk/news/article/6-tax-changes-to-watch-out-for-in-2023)

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Extract B

UK Monetary Policy Decisions

At a special meeting on 19th March 2020, the monetary policy committee of the Bank of England announced further measures to help support the UK economy during the global health crisis. It voted to reduce the base rate of interest to 0.1% and restart the quantitative easing programme by buying £200 billion of UK government bonds and corporate bonds. This followed a number of announcements by the UK government to try and limit the damage of the deep recession the country was facing and reduce the chances of deflation occurring in the UK. Government borrowing grew massively during 2020 and 2021 to fund support for businesses and workers.

However, since then the monetary policy committee has rapidly increased the base rate of interest – which reached 4% in February 2023. The UK government's long-term borrowing costs are higher today than they were before former prime minister Liz Truss's £45 billion proposed tax cuts caused the interest rate on 30-year government bonds to briefly rise above 5%, which almost caused a financial crisis.

The Bank's use of quantitative easing (QE) has also come in for criticism, with former governor of the Bank of England Mervyn King saying that the decision to keep pumping money into the economy during the global health crisis was a mistake that fuelled inflation. He said: 'central banks decided it was a good time to print a lot of money. That was a mistake [as] we had too much money chasing too few goods'.

Experts have argued this pushed inflation higher in the UK by stimulating aggregate demand. However, critics say QE does not cause inflation as most of the extra money is contained in the financial system and does not affect consumption and investment.

Higher interest rates on the national debt may limit the ability of the UK government to increase spending on supply-side policies needed to boost economic growth, such as a £20 billion plan to transform carbon capture in the UK, which would create jobs and support a move to cleaner electricity generation and technology.

(Source: adapted from: https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2020/monetary-policy-summary-for-the-special-monetary-policy-committee-meeting-on-19-march-2020 and https://www.ft.com)

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6 (a) With reference to Figure 4 and your own knowledge, explain the distinction between a progressive and a regressive tax.

(5)

(b) With reference to Figure 4 and Extract A, examine the likely impact of the 'freeze in income tax thresholds' (Extract A line 1) on aggregate demand.

(8)

(c) Assess whether a fiscal deficit **and** national debt should be a cause for concern for the UK government.

(10)

(d) With reference to Extract B, discuss the use of quantitative easing in preventing deflation.

(12)

(e) Discuss supply-side policies the UK government could introduce to stimulate economic growth.

(15)

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6 (a) With reference to Figure 4 and your own knowledge, explain the distinction between a progressive and a regressive tax.

(5)

A progressive tax is one where the proportion of income paid in tax increases as income increases, so the average tax rate rises as income rises. UK income tax is progressive: Figure 4 shows people earning up to £12 570 pay 0% (personal allowance), then income is taxed at 20%, 40% between £50 271 and £125 140, and 45% over £125 140. Lowering the additional-rate threshold means someone earning £150 000 pays an extra £1 200 a year.

A regressive tax is one where the proportion of income paid in tax decreases as income increases. VAT at 20% and excise duties such as tobacco duty are regressive: low-income households spend a larger proportion of their income, so these taxes take a larger share of a poor household's income than a rich one's.

The key distinction is that a progressive tax places a greater burden on higher incomes and reduces income inequality (lowering the Gini coefficient), while a regressive tax places a greater burden on lower incomes and increases income inequality. Income tax is a direct tax, while most regressive taxes are indirect taxes on spending.

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(b) With reference to Figure 4 and Extract A, examine the likely impact of the 'freeze in income tax thresholds' (Extract A line 1) on aggregate demand.

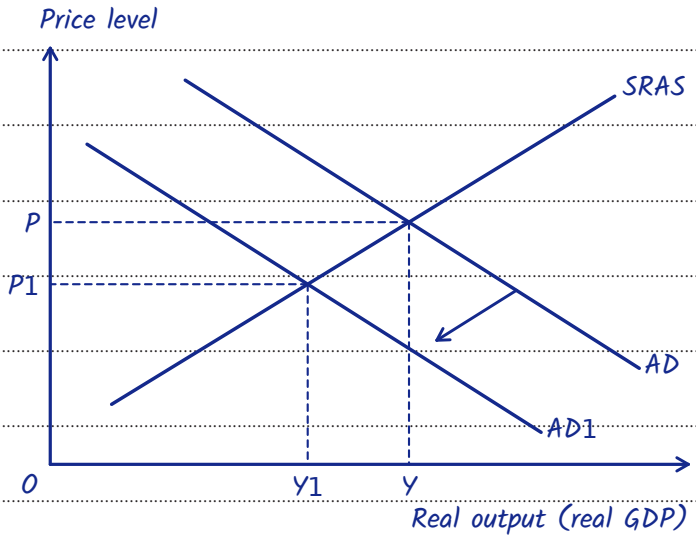
(8)

Aggregate demand is total planned spending on an economy's goods and services, AD = C + I + G + (X − M). Freezing income tax thresholds until April 2028 while salaries rise causes 'fiscal drag': people 'will still end up paying more tax on their income', particularly if pushed into a higher tax band. Figure 4 shows the personal allowance, basic and higher-rate thresholds are unchanged, while the additional-rate threshold falls from £150 000 to £125 140.

Higher taxes reduce real disposable income, so consumers will have less money to spend. Consumption is the largest component of AD, so AD shifts left from AD to AD1, real output falls from Y to Y1 and the price level from P to P1. Around 250 000 taxpayers will be pushed into the 45% band, and a person earning £150 000 will pay an extra £1 200 a year. Lower demand from consumers reduces firms' incentive to invest, and through the negative multiplier effect firms may reduce staff, raising unemployment and slowing economic growth. Higher marginal tax rates may also reduce the incentive to work. However, the impact may be small. High earners have a low marginal propensity to consume, so they may save less rather than reduce consumption. If the government spends the extra tax revenue, G rises and offsets the fall in C, creating employment. As inflation falls, wages will rise more slowly, limiting fiscal drag. Revenue may also be lower than expected due to tax avoidance (the Laffer curve). Overall, AD is likely to grow more slowly rather than fall sharply, depending on the size of the multiplier and the level of spare capacity.

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(c) Assess whether a fiscal deficit **and** national debt should be a cause for concern for the UK government.

(10)

A fiscal deficit is when government spending exceeds tax revenue in a year, while the national debt is the accumulated total of past borrowing that has not been repaid. Figure 2 shows the UK fiscal deficit peaked at about 10% of GDP in 2009–10 and about 15% in 2020–21, and Figure 1 shows the national debt rose from about 27% of GDP in 2001–02 to about 94% in 2020–21.

A large fiscal deficit is a cause for concern because the government will have to borrow more to finance it, increasing the national debt. Borrowing to fund spending when the economy is near full capacity can be inflationary. If markets lose trust, the government may struggle to borrow in future, risking a downgrade in its credit rating.

A high national debt is a cause for concern because of the opportunity cost of debt interest payments. Figure 3 shows the interest rate on 10-year UK government bonds rose from about 2% in July 2022 to about 4.5% in October 2022, so every new bond costs far more to service. Money spent on interest cannot be spent on the NHS or education, and could lead to future tax rises and spending cuts, creating intergenerational inequity as future taxpayers repay today's debt. Heavy government borrowing raises interest rates and causes financial crowding out of private sector investment, and may reduce business confidence and cause a depreciation of the pound, making imports more expensive.

However, the deficit may not be a cause for concern. Much of the 2020–21 deficit was cyclical, needed to support the UK economy during the global health crisis through furlough and business support, and should fall as the economy recovers. Borrowing to fund infrastructure or education can raise long-run growth and pay for itself through higher future tax revenue, even 'crowding in' private investment.

Whether the debt matters depends on its size relative to GDP and the cost of servicing it. UK debt was over 200% of GDP after the Second World War and Japan's is over 250%

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today. The UK borrows in its own currency with long maturities, so default risk is low, and fiscal drag from frozen tax thresholds will raise revenue. However, the rise in bond yields after the 2022 mini-budget shows markets can lose confidence quickly. Overall, a cyclical deficit in a crisis is not a major concern, but with debt near 100% of GDP and rising interest rates a persistent structural deficit should be a concern.

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(d) With reference to Extract B, discuss the use of quantitative easing in preventing deflation.

(12)

Deflation is a sustained fall in the general price level. It is harmful because consumers delay purchases expecting lower prices, the real value of debt rises, and confidence, investment and growth fall. Quantitative easing (QE) is when the central bank creates new money electronically to buy bonds from financial institutions. In March 2020 the Bank of England cut the base rate to 0.1% and restarted QE, 'buying £200 billion of UK government bonds and corporate bonds', to reduce the chances of deflation.

Buying bonds increases demand for them, raising bond prices and lowering bond yields, so long-term interest rates fall. Banks receive extra liquidity, which increases the availability of credit. Lower commercial interest rates reduce the cost of borrowing and the reward for saving, so consumption and investment rise, shifting AD right from AD to AD1 and raising the price level from P to P1, preventing deflation.

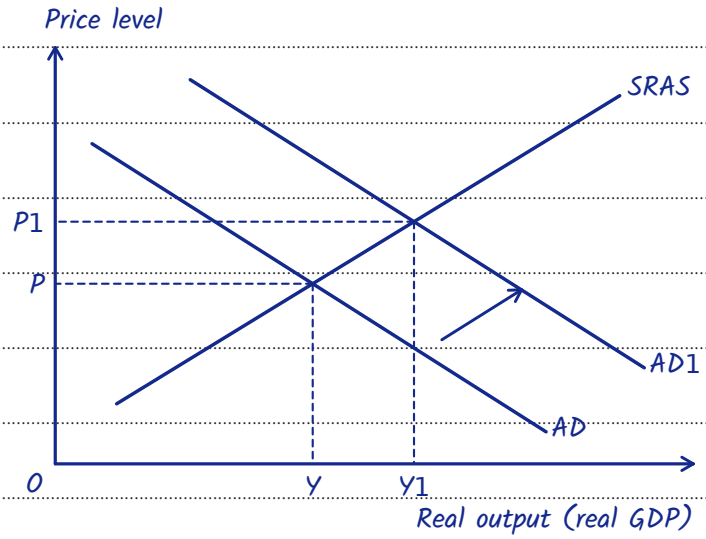
QE also raises asset prices such as shares and houses, creating a positive wealth effect that boosts consumption. Lower interest rates cause hot money outflows and a depreciation of the pound, so exports become cheaper and net exports rise, while dearer imports cause cost-push inflation. QE also lowers the cost of government borrowing, enabling the government spending that grew 'massively during 2020 and 2021'.

However, during the global health crisis consumer and business confidence was very low, so households and firms may not borrow and spend even at very low interest rates, a liquidity trap. Commercial banks may be reluctant to lend due to uncertainty and may retain the extra money: critics say 'most of the extra money is contained in the financial system and does not affect consumption and investment'. Rising asset prices mainly benefit wealthier households, increasing inequality.

On the other hand, QE may have been too effective. Mervyn King argued it 'fuelled inflation' with 'too much money chasing too few goods', and CPI inflation rose above 10%

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in 2022, far above the 2% target, forcing base rate rises to 4% by February 2023. With the base rate close to 0%, QE was a last resort, and fiscal policy such as furlough also helped prevent deflation, so the effect of QE alone is hard to isolate. Overall, QE was effective in preventing deflation in 2020, but the scale and timing of its use risked overshooting the inflation target.



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(e) Discuss supply-side policies the UK government could introduce to stimulate economic growth.

(15)

Supply-side policies aim to increase the productive capacity of the economy by improving the quantity and quality of factors of production, shifting LRAS right. Economic growth is an increase in real GDP.

Firstly, the government could increase spending on infrastructure, such as the 'plan to transform carbon capture in the UK' worth £20 billion. This 'would create jobs and support a move to cleaner electricity generation and technology', lowering firms' costs and increasing the potential output of the economy. In my diagram LRAS shifts right from LRAS to LRAS1, raising real GDP from Y to Y1 with a lower price level, P to P1, giving sustainable non-inflationary growth. The spending also increases AD in the short run through the multiplier effect.

Secondly, increased spending on education, training and healthcare raises the skills and productivity of the workforce. Retraining reduces structural unemployment and occupational immobility, and higher productivity improves international competitiveness, boosting exports.

Thirdly, market-based policies such as cutting corporation tax or income tax increase incentives to work, invest and take risks, while deregulation, planning reform and privatisation increase competition and efficiency. Labour market reforms, such as reducing the cost and paperwork of immigration or improving childcare to raise participation, increase the size of the labour force. Subsidies for strategic industries such as electric cars can also attract investment.

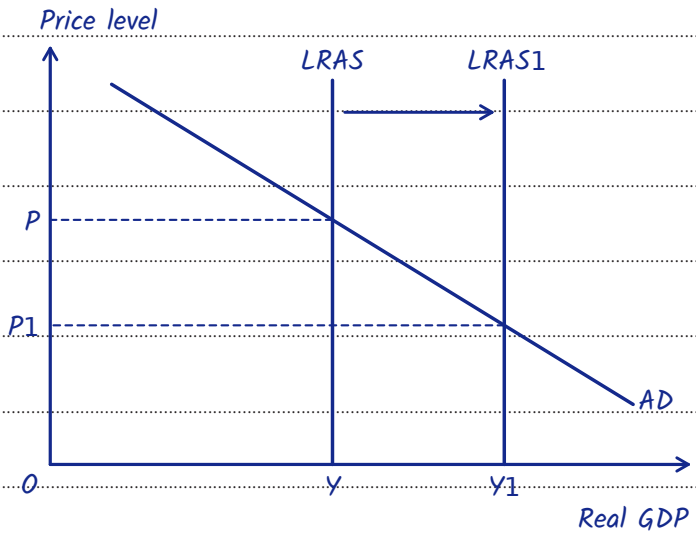
However, interventionist supply-side policies are expensive. Extract B notes 'higher interest rates on the national debt may limit the ability of the UK government to increase spending on supply-side policies'. With national debt at about 94% of GDP (Figure 1) and 10-year bond yields of around 3.5% in March 2023 (Figure 3), extra borrowing increases the budget deficit and may cause crowding out. Unfunded tax cuts are also risky: Liz

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Truss's £45 billion proposed tax cuts pushed 30-year bond yields above 5%, which almost caused a financial crisis.

Supply-side policies also have long time lags. Carbon capture is new, unproven technology that will take years to build and develop, and a student takes many years to progress through education, so they do little to stimulate growth in the short run, when demand-side policies such as interest rate cuts may be more effective. There is a risk of government failure if the government picks the wrong projects, and a larger labour force only helps if there are jobs available. Tax cuts may increase inequality and may simply be saved.

In conclusion, supply-side policies are essential for long-run growth, as the UK has weak productivity. The most effective approach is likely to be targeted interventionist spending on infrastructure, skills and green technology combined with low-cost market-based reforms such as planning reform, but their magnitude is constrained by the high national debt and borrowing costs, so the government must prioritise carefully.



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(Total for Question 6 = 50 marks)

TOTAL FOR SECTION B = 50 MARKS

SECTION C

Answer ONE question from this section.

Write your answer in the spaces provided.

You are advised to spend 30 minutes on this section.

EITHER

7 In 2021 Brazil's current account deficit on the balance of payments was US$46.12 billion. The Central Bank of Brazil intervened to sell its own currency, the *real*, on September 23rd 2022. This was the first time it has intervened in foreign currency markets since December 2021.

(Source adapted from: https://www.statista.com/statistics and https://www.centralbanking.com/central-banks/reserves/foreign-exchange/7953193/brazil-makes-first-fx-intervention-of-the-year)

Evaluate macroeconomic policies that could be used to reduce a current account deficit. Refer to a country of your choice in your answer.

(Total for Question 7 = 25 marks)

OR

8 In 2020, exports as a share of world GDP were 12% higher than in 2000, almost twice as high as 50 years ago.

(Source adapted from: https://www.dhl.com/content/dam/dhl/global/dhl-spotlight/documents/pdf/2021-gci-update-report.pdf)

Evaluate the possible factors contributing to globalisation.

(Total for Question 8 = 25 marks)

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

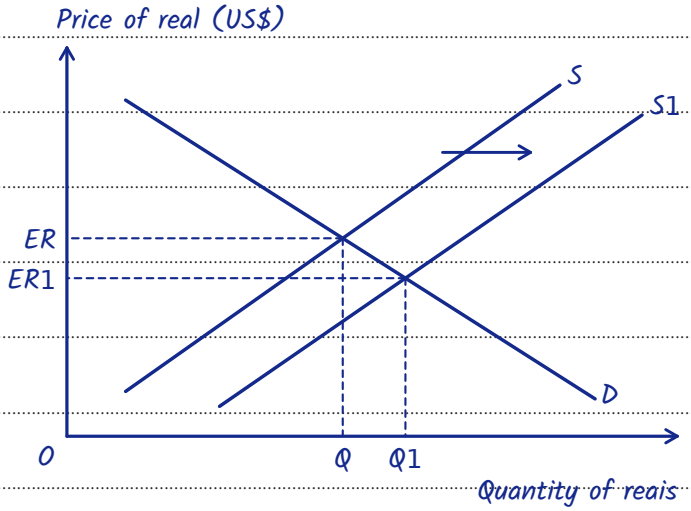
The current account of the balance of payments records trade in goods and services, primary income and secondary income. A deficit means more money flows out than in, mainly because imports exceed exports. Brazil had a current account deficit of US$46.12 billion in 2021, roughly 3% of its GDP, and the UK has run a persistent deficit of around 3% to 4% of GDP, largely due to a large deficit in trade in goods.

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The first policy is to reduce the external value of the currency. The Central Bank of Brazil sold its own currency, the real, on 23 September 2022. This increases the supply of reais on the foreign exchange market, shifting S to S1 in my diagram, so the exchange rate falls from ER to ER1. The same can be achieved by expansionary monetary policy: cutting interest rates causes hot money outflows. A depreciation makes Brazilian exports, such as soya beans, iron ore and coffee, cheaper in foreign currencies and makes imports more expensive in reais. This expenditure switching increases demand for exports and reduces demand for imports, improving



the current account.

However, according to the Marshall-Lerner condition a depreciation only improves the current account if the combined price elasticities of demand for exports and imports are greater than one. In the short run demand is price inelastic, as contracts are fixed and buyers take time to switch, so the deficit may worsen before improving, the J-curve effect. Many of Brazil's exports are commodities priced in US dollars, so a weaker real may do little to increase demand for them. A depreciation also causes imported cost-push inflation, which erodes the competitive advantage over time, and intervention requires large foreign currency reserves. In the UK, the Bank of England is independent with a 2% inflation target and a floating exchange rate, so it would not manipulate the exchange rate or interest rate to reduce the deficit.

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The second policy is deflationary fiscal or monetary policy, which is expenditure reducing. Higher income tax rates reduce disposable income, so consumers spend less, including on imports, depending on the marginal propensity to import. Higher interest rates also reduce consumer spending on imports and lower inflation below that of competitors, improving price competitiveness over time. However, both policies conflict with other macroeconomic objectives: lower AD reduces economic growth and increases unemployment. Higher interest rates also attract hot money inflows, causing the currency to appreciate, which reduces the price competitiveness of exports and may worsen the deficit.

The third policy is supply-side policy, which improves international competitiveness. Spending on education and training, infrastructure and tax breaks for R&D raises productivity, lowers unit costs and improves non-price factors such as quality and design. Brazil could diversify from primary commodities into exports with more value added, such as manufactured goods and aircraft, as Embraer has done. This is the most sustainable solution, as it tackles the root cause of the deficit. However, supply-side policies have long time lags, taking years to have an effect, and interventionist spending is costly, increasing the budget deficit and national debt and possibly causing crowding out.

The fourth policy is protectionism, such as tariffs, quotas and subsidies to domestic producers, which makes imports more expensive and switches spending to domestic goods. However, protectionism distorts comparative advantage, reducing specialisation and trade, raises prices for consumers and firms that use imported inputs, and can result in retaliation, which reduces exports. Members of the WTO and trade blocs such as Mercosur, or the UK with its free trade agreements, are restricted in their ability to impose tariffs.

Finally, it is important to consider whether the deficit needs to be addressed at all. A deficit can be financed by surpluses on the financial account, such as inflows of foreign direct investment, which Brazil attracts. A deficit caused by importing capital goods may raise future productive capacity. With a floating exchange rate, a deficit should be partly self-correcting as

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the currency depreciates. The UK has run a deficit for decades, financed by financial inflows, without a crisis.

In conclusion, a combination of policies is needed. Depreciation and expenditure-reducing policies can reduce the deficit in the short run, but they conflict with low inflation and growth and depend on price elasticities. Supply-side policies are the most effective in the long run as they improve competitiveness, but take time. For Brazil, with many exports priced in dollars, diversification is likely to be most important, and the magnitude of the deficit, at around 3% of GDP, suggests it is not an urgent concern.

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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, labour and technology, and the growth of transnational corporations (TNCs). In 2020, exports as a share of world GDP were 12% higher than in 2000, almost twice as high as 50 years ago.

The first factor is the reduced cost of transport. Containerisation since the 1960s has greatly reduced the cost and time of shipping goods, as containers can be moved quickly between ships, trains and lorries, while larger ships, increased fuel efficiency and better infrastructure such as ports and airports have lowered costs further. Lower transport costs mean goods produced in Asia can be sold cheaply in Europe, so countries can exploit their comparative advantage, specialise and trade more.

The second factor is reduced costs of communication and technological advances. The internet, mobile technology and electronic payment systems make it easy and cheap for firms to communicate with suppliers and customers worldwide, coordinate production and trade services such as banking, software and call centres. E-commerce platforms allow even small firms to export.

The third factor is trade liberalisation. Successive rounds of negotiations under GATT and the WTO have greatly reduced tariffs and other trade barriers. According to the law of comparative advantage, if countries specialise in goods they can produce at a lower opportunity cost and trade, world output and living standards increase, which encourages governments to open up. Increased number and size of trading blocs, such as the EU single market, ASEAN and USMCA, have also increased trade through trade creation.

The fourth factor is political change. The opening up of previously closed economies to the world market, such as China after 1978 and its joining of the WTO in 2001, and the breakdown of the Soviet system after 1991, added billions of workers and consumers to the global economy. Financial liberalisation, removing controls on capital flows, also allowed money to flow freely

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across borders.

The fifth factor is the increased significance of TNCs and foreign direct investment. TNCs such as Apple and Toyota have entered new markets and invested significantly abroad, offshoring and outsourcing production to benefit from lower labour costs, for example assembling electronics in China or Vietnam. This has created global supply chains, as firms produce different parts of their finished products in different countries, so components cross borders several times, increasing trade.

However, the significance of these factors varies. Reduced transport costs do not benefit all countries equally; landlocked countries or those with poor infrastructure, such as many in Sub-Saharan Africa, face high transport costs and remain less integrated. Similarly, many people in developing countries are excluded from the benefits of the internet and mobile technology because they are poor, a digital divide.

In addition, there is evidence of deglobalisation in recent years. Trade wars between the USA and China, with tariffs on hundreds of billions of dollars of goods and more recently increases in US tariffs on Chinese cars, have reduced trade, and countries have left trading blocs, such as the UK leaving the EU in 2020. Trading blocs can also cause trade diversion rather than trade creation. There is now limited scope for further tariff removal, as average tariffs are already low.

The importance of TNCs may also decline. Delays and uncertainty in global shipping during the global health crisis encouraged some firms to reshore production or simplify their supply chains, and increased automation reduces the importance of labour costs in firms' decisions about where to locate production, so offshoring to low-wage countries is less attractive.

It is also difficult to isolate one factor, as they are interdependent; a combination of factors is more significant than any one alone. TNCs could only build global supply chains because transport and communication costs fell and trade barriers were removed. Different factors are also more important for different countries: political change was key for China, while trade

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blocs mattered most for EU members.

In conclusion, technological change in transport and communication is probably the most significant factor, because it has made trade cheaper for all countries and enabled the growth of TNCs and global supply chains, while trade liberalisation and political change provided the policy environment. However, the slowdown in globalisation since the 2008 financial crisis shows that political decisions can reverse the trend, so the future pace of globalisation depends on whether governments continue to support free trade.

TOTAL FOR SECTION C = 25 MARKS
TOTAL FOR PAPER = 100 MARKS

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