A-level

ECONOMICS

Paper 2 National and International Economy

Thursday 23 May 2019 Morning Time allowed: 2 hours

Materials

For this paper you must have:

- an AQA 12-page answer book
- a calculator.

Instructions

- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is 7136/2.
- In **Section A**, answer **EITHER** Context 1 **OR** Context 2.
- In **Section B**, answer **one** essay.

Information

- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- You will be marked on your ability to:
  - use good English
  - organise information clearly
  - use specialist vocabulary where appropriate.

Advice

- You are advised to spend 1 hour on **Section A** and 1 hour on **Section B**.

Section A

Answer **EITHER** Context 1 **OR** Context 2.

EITHER

Context 1 **Total for this context: 40 marks**

GDP and living standards

Study **Extracts A**, **B and C** and then answer **all** parts of Context 1 which follow.

Extract A

Figure 1: Selected data for Costa Rica, UK and USA, 2015/2016 unless stated

	Costa Rica	UK	USA
GDP (PPP $bn)	69.6	2 518.1	16 890.2
Population (millions)	4.9	64.7	321.8
Mean years of schooling	8.7	13.3	13.2
Infant mortality rate (under 5s per 1000 births)	9.7	4.2	6.5
Average annual increase (%) of the HDI (1990–2015)	0.7	0.6	0.3
Gini coefficient (average 2010–2015)	0.49	0.33	0.41
CO_2 emissions (tonnes per capita)	1.6	6.2	16.1

Footnote: PPP = Purchasing Power Parity
HDI = Human Development Index

Source: United Nations and World Bank

Extract B: What is GDP?

Imagine £50 notes stacked on top of each other, stretching almost 4500 kilometres into the sky. This fantastically large amount of money (more than £2 trillion) is the current estimated value of the UK's Gross Domestic Product (GDP).

GDP is the standard measure of the size and health of a country's economy but it is important to distinguish between nominal and real GDP. It's the way we measure and compare how well or badly countries are doing. In other words, it is the total value of the output of goods and services produced in an economy over a period of time. The higher the value of GDP, the bigger the economy. If injections into an economy's circular flow of income increase, then this may generate multiple increases in GDP, depending upon the size of the marginal propensity to consume.

Why is the measurement of GDP important? Well, it's a way of keeping track of how the economy is doing, and whether it is growing. We can also use it to measure one economy against other economies using purchasing power parity exchange rates. If real GDP goes up, the economy is doing well; this is associated with higher incomes, more jobs and higher spending. If real GDP goes down, the economy is not doing so well; this is associated with falling incomes, lower consumption and a lower standard of living.

Source: News reports, 2017

Extract C: A happy planet?

We are facing tough times. The crises that dominate the media today are set against a background of an increasingly unstable global economy, rising inequalities and the ever-present challenges of climate change. GDP growth on its own does not mean a better life for everyone, particularly in countries that are already wealthy. This growth of GDP may not reflect inequalities in material conditions between people in a country and does not value the things that really matter to people, such as social relations, health, or how they spend their free time.

The Happy Planet Index is one of the alternative ways of measuring what really matters: sustainable wellbeing for all. This year, Costa Rica has topped the Happy Planet Index for the third time, achieving relatively high life expectancy and wellbeing with a small ecological footprint. Costa Ricans generally have higher wellbeing than the residents of many rich nations and live longer than people in the USA (who are ranked 108th in the index). This is achieved with an impact on the environment which is much smaller than that of the USA or UK (ranked 34th).

Costa Rica is a world leader when it comes to environmental protection, with 99% of its electricity coming from renewable sources, and a commitment to becoming carbon neutral by 2021. They also abolished the army in 1949 and reallocated the defence budget to funding education, health and pensions, further enriching the lives of its citizens. Other measures of living standards, such as the HDI, do not rank Costa Rica quite so highly (66th compared to the USA in 10th position). This is because the HDI does not place as much emphasis on the environment compared to the Happy Planet Index.

Increasingly economic growth is incompatible with the planetary limits we are up against. Rising GDP may be a sign that we are using more of the earth's scarce resources. Some believe the Happy Planet Index gives a clearer picture of broader living standards and their sustainability.

Source: News reports, 2017

0 1 Using the data in **Extract A**, calculate the GDP per capita for Costa Rica in 2015/2016 to the **nearest dollar**.

[2 marks]

0 2 Explain how the data in **Extract A** indicate living standards may be higher in the UK than in the USA.

[4 marks]

0 3 **Extract B** (lines 8–9) states 'If injections into an economy's circular flow of income increase, then this may generate multiple increases in GDP.'

With the help of a diagram, explain how an increase in injections may generate multiple increases in an economy's GDP.

[9 marks]

0 4 **Extract B** (lines 13–15) states 'If real GDP goes up, the economy is doing well; this is associated with higher incomes, more jobs and higher spending.'

Using the data in the extracts and your knowledge of economics, assess the view that to improve the living standards of their citizens, governments across the world should prioritise achieving economic growth.

[25 marks]

Do **not** answer Context 2 if you have answered Context 1.

OR

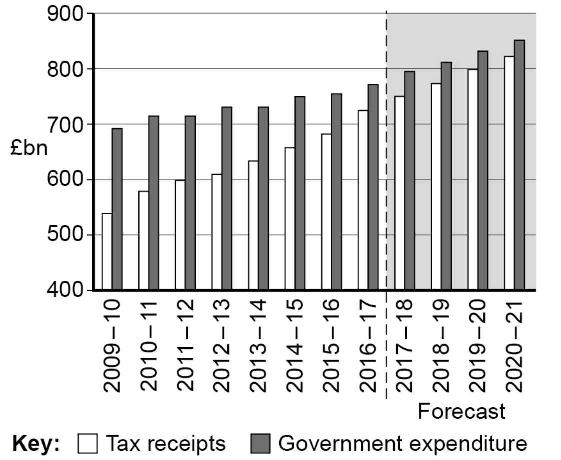
Context 2 **Total for this context: 40 marks**

UK fiscal policy and taxation

Study **Extracts D**, **E and F** and then answer **all** parts of Context 2 which follow.

Extract D

Figure 2: UK Government expenditure and tax receipts, 2009–2021



Source: OBR

Figure 3: Marginal income tax rates in Scotland and the rest of the UK, April 2018

Scotland		**Rest of the UK**	
Tax Band £	**Tax Rate**	**Tax Band £**	**Tax Rate**
0 – 11 850	0%	0 – 11 850	0%
11 851 – 13 850	19%	11 851 – 46 350	20%
13 851 – 24 000	20%		
24 001 – 43 430	21%		
43 431 – 150 000	41%	46 351 – 150 000	40%
150 001+	46%	150 001+	45%

Source: gov.uk

Extract E: Deficit reduction

In 2017, the Chancellor of the Exchequer claimed that the government was on course to create a budget surplus by 2025. However, the Office for Budget Responsibility (OBR) has suggested that the budget deficit will not be wiped out until 2031. This is 16 years later than originally forecast.

The Government borrowed £52bn in 2016–17, a fall of £20bn compared to the year before, as the long struggle to eliminate the deficit moved closer towards its goal. However, the OBR has forecast a ‘weaker’ economy than it did just nine months ago; it expects economic growth to slow and government borrowing to rise as a result. The OBR also delivered the biggest downgrade to productivity growth in its history, with output per hour expected to be 4.6% lower in 2022 than originally forecast.

The financial crisis of 2007–08 led to a budget deficit of almost 11% of GDP in 2009–10; the deficit has now fallen to 2.6% of GDP, the lowest level of borrowing since 2007–08. If growth could be increased, the budget deficit would fall much faster.

Why is deficit reduction so important in the first place? Firstly, there are the negative effects of larger interest repayments caused by a higher national debt. There is also the argument that public spending crowds out the private sector. Some economists point to the effects on future generations and the possibility that the government’s credit rating may fall if borrowing is high.

Source: News reports, 2017

Extract F: Scottish income tax

In most of the UK, reducing the budget deficit has focused on austerity rather than tax rises. However, the Scottish Government has announced that from April 2018, Scotland will have different rates of income tax to the rest of the UK, with changes that will see higher earners pay more and lower earners pay less. There will be a new tax band of 21% for those earning more than £24 000. The higher rate of tax will be increased from 40% to 41% and the top rate from 45% to 46%. A starter rate of 19% will also be introduced. The move to a 'five-band' income tax system should mean that nobody earning less than £33 000 in Scotland will pay more tax than they do now.

Estimates show that 55% of Scottish taxpayers will pay less compared to the rest of the UK under the new system, with higher earners paying more. Someone in Scotland earning £150 000 will pay £1774 more than if they lived elsewhere in the UK, with someone earning £40 000 paying £140 more. The extra revenue raised will be used to give public sector workers a 3% pay rise for those earning less than £30 000, and a 2% rise for those earning more than that, and will help towards the cost of providing superfast broadband to all premises in Scotland by 2021.

Some business leaders have warned that Scotland cannot afford to be associated with higher taxation than the rest of the UK. The Finance Minister for Scotland, Derek Mackay, claimed the changes could raise an additional £164 million and were necessary to "mitigate UK budget cuts, protect our NHS and other public services, support our economy and tackle inequality in our society". He said the tax reforms would make "Scotland's income tax system even fairer and more progressive". He resisted a bigger increase in the top rate of tax for those earning more than £150 000, aware that high earners may find ways to avoid paying it.

Source: News reports, 2017

0 5 Using the data in **Extract D** (Figure 3), calculate, to the **nearest pound**, the amount of income tax payable for someone in Scotland earning £13 500.

[2 marks]

0 6 Explain how the data in **Extract D** (Figure 2) show that the UK's public finances have been improving since 2010.

[4 marks]

0 7 **Extract E** (lines 11–12) states 'If growth could be increased, the budget deficit would fall much faster.'

With the help of a diagram, explain why a higher rate of economic growth is likely to reduce the budget deficit.

[9 marks]

0 8 **Extract F** (line 1) states 'In most of the UK, reducing the budget deficit has focused on austerity rather than tax rises.'

Using the data in the extracts and your knowledge of economics, evaluate the view that there is a strong case for significant increases in UK income tax rates.

[25 marks]

Section B

Answer **one** essay from this section.

Each essay carries 40 marks.

EITHER

Essay 1

Between 2014 and 2018, the pound fell by more than 20% against the dollar and euro. Some argued that this would benefit the UK's macroeconomic performance, but others claimed that a lower exchange rate will cause problems.

0 9 Explain why the value of a currency may fall in a floating exchange rate system.

[15 marks]

1 0 Assess the view that a depreciation of the pound against other currencies is likely to improve the UK's macroeconomic performance.

[25 marks]

OR

Essay 2

Since 1998, the Bank of England has had responsibility for the operation of monetary policy and maintaining price stability. In response to the financial crisis of 2007–08, the Financial Services Act 2012 gave the Bank of England overall responsibility for financial stability. This was designed to reduce systemic risk and the impact on the real economy of problems that arise in financial markets.

1 1 Explain how the monetary policy transmission mechanism works when the Monetary Policy Committee (MPC) raises Bank Rate.

[15 marks]

1 2 Evaluate the view that strict rules and regulations on financial markets are essential to help create a more stable economy.

[25 marks]

OR

Essay 3

In the past few years, CPI inflation has often differed by more than 1% from its 2% target. In the winter of 2015 the UK experienced a brief period of deflation but, more recently, inflation has been over 3%.

13 Explain the main causes of a rise in inflation.

[15 marks]

14 Evaluate the view that inflation is always preferable to deflation.

[25 marks]

END OF QUESTIONS

There are no questions printed on this page